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November 22, 2004

Tennessee Regulatory Authority
Attn: Chairman Pat Miller
c/o Sharla Dillon, Docket Manager
460 James Robertson Parkway
Nashville, TN 37243-0505

Via Federal Express
Priority Overnight Delivery

Re: Consolidated Docket Nos. 01-00704 and 02-00850

Dear Ms. Miller:

Please find enclosed the original and fourteen copies of Atmos Energy Corporation's Post-Hearing Brief for filing in the above-referenced matter. Please stamp the extra enclosed copy "filed" and return it to me in the enclosed envelope.

If you have any questions about this filing please give me a call.

Sincerely,

Kasey Cannon

Kasey Cannon,
Assistant to Misty Smith Kelley

/klc
Enclosures

LATE FILED

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
UNITED CITIES GAS COMPANY,	)	
a Division of ATMOS ENERGY	)	Consolidated Docket Nos. 01-00704 and
CORPORATION INCENTIVE	)	02-00850
PLAN (IPA) AUDIT	)	
	)	
UNITED CITIES GAS COMPANY,	)	
a Division of ATMOS ENERGY	)	
CORPORATION, PETITION TO	)	
AMEND THE PERFORMANCE	)	
BASED RATEMAKING	)	
MECHANISM RIDER	)	

ATMOS ENERGY CORPORATION'S POST-HEARING BRIEF

BAKER, DONELSON, BEARMAN
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Atmos Energy Corporation ("Atmos" or "the Company")[1] submits this Post-Hearing Brief as required by the October 20, 2004 Order Setting Procedural Schedule for Filing Post-Hearing Briefs in this matter.

As discussed more thoroughly below, the evidence and testimony in this docket demonstrates that Atmos is entitled to share in savings resulting from the transportation discounts it has negotiated and from the Company's NORA Contract under the terms of the current PBR plan. The evidence also demonstrates that the TIF amendment proposed by Atmos and supported by the TRA Staff is just and reasonable and in the best interest of the Company and consumers. As such, Atmos' objections to the 2000-2001 audit should be sustained. In addition, the proposed TIF tariff should be approved effective April 1, 2001.

I. BACKGROUND OF ATMOS' PERFORMANCE BASED RATEMAKING MECHANISM.

The dispute in this case centers around the parties' differing interpretations of the performance based ratemaking mechanism ("PBR") contained within Atmos' tariff; the proper application of the PBR to Atmos' Incentive Plan Account for the 2000-2001 plan year (Docket No. 01-00704), and whether an amendment to the PBR proposed by TRA Staff and the Company should govern the audits of subsequent plan years (Docket No. 02-00850).

In 1999, after a two-year experimental period and extensive hearings, and over the objections of the Consumer Advocate and Protection Division ("CAPD"), the TRA approved an amendment to Atmos' tariff implementing a permanent PBR plan The permanent PBR plan is

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[1] Previous filings in this consolidated docket refer to "United Cities Gas" or "UCG," rather than Atmos United Cities Gas is an unincorporated division of Atmos Energy Corporation which previously did business in Tennessee as United Cities Gas Company During the pendency of this case, Atmos elected to cease doing business as United Cities Gas Company, and to instead use the company's legal corporate name, Atmos Energy Corporation In all proceedings before the Tennessee Regulatory Authority, the terms "United Cities Gas Company" and "Atmos Energy Corporation" have the same meaning and can be used interchangeably

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encompassed within the April 1999 Phase Two Order in Docket No. 97-01364 ("Phase 2 Order"), and became effective April 1, 1999.[2] The purpose of the PBR plan is to eliminate the need for the TRA to hire a consultant to conduct a yearly prudency review of Atmos' gas procurement, storage, and capacity activities, by giving the Company an incentive to find and aggressively pursue cost savings in all of its purchasing activities on an ongoing basis. (Phase Two Order, pp. 1-2.) Under the PBR plan, Atmos' performance is evaluated on a monthly basis by comparing the Company's purchases with defined benchmarks which act as surrogates for the market. (Id.) The PBR creates an incentive for Atmos to out-perform the market in its acquisition of gas supply and transportation services by allowing Atmos to share in savings obtained. (Id.)

The PBR allows Atmos to share in savings it generates through two mechanisms: (1) the Gas Procurement Incentive Mechanism (also referred to as Gas Commodity Cost Mechanism); and (2) the Capacity Management Incentive Mechanism (also referred to as the Capacity Release Sales Mechanism.) (Phase 2 Order, pp. 23-24.) The parties agree that the issues of this consolidated docket deal solely with the proper treatment of transportation costs under the Gas Procurement Incentive Mechanism. (See Direct Testimony of Dan McCormac, p. 6.)

Under the Gas Procurement Incentive Mechanism, Atmos, on a monthly basis, must compare its gas costs to a benchmark amount defined within the PBR. (TRA Gas Tariff of Atmos Energy Corporation, Sheet Nos. 45.1-45.7 ("PBR Tariff").) The benchmark amount consists of an average of various published industry price indexes (Id.) If Atmos' gas costs fall within a deadband of 97.7% to 102% of the total of the benchmark amount, no incentive savings or costs

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[2] At the October 19, 2004 hearing in this matter, Atmos' Request to Take Official Notice was granted (Hearing Trans Vol I, p 6) As such, the TRA may take official notice of all filings in this consolidated docket, the original PBR docket (Docket No 97-01364), and the docket granting the Company's request to include the NORA Contract in the permanent PBR plan (Docket No 00-00844)

are computed. (Id.) If Atmos's gas costs are above 102% of the benchmark amount, Atmos must pay 50% of the costs incurred above the 102% mark. (Id.) If Atmos' total gas costs for the month are below 97.7% of the benchmark amount, Atmos is entitled to retain 50% of those savings. (Id.) The remaining 50% of any costs incurred or savings obtained outside the deadband are passed on to the consumers. (Id.)

Under the PBR, Atmos must file annual and quarterly reports of the savings and losses in the Incentive Plan Account, which is the Company's calculation of its share of savings obtained and losses incurred under the PBR mechanisms. (PBR Tariff at Sheet No. 45.6.) The annual report is audited by the Energy and Water Division (now the Utilities Division) of the TRA. (Id.)

II. PROCEDURAL BACKGROUND AND TRAVEL OF THE CASE.

A. *The Audit Case (Docket No. 01-00704).*

On August 7, 2001, Atmos filed its annual report of the Incentive Plan Account for the second year of the permanent PBR plan, which encompassed the period from April 1, 2000 to March 31, 2001. (Docket No. 01-00704 (the "Audit Case"), Notice of Filing by Energy and Water Division of the TRA, pp. 1-2.) Pat Murphy of the Energy and Water Division conducted the audit. (Id. at p. 2.) On March 28, 2002, the Staff issued its preliminary audit findings, and the Company responded on April 5, 2002. (Notice of Filing by Energy and Water Division of the TRA, Exhibit A ("Audit Report") at pp. 1-2.) The Staff's Audit Report was modified to include the Company's responses and filed in Docket No. 01-00704 on April 10, 2002. (Id.)

In its Audit Report, the Staff disallowed the $526,265 in savings the Company reported from discounted transportation contracts and $100,947 in savings from the Company's contract with the East Tennessee-NORA gas pipeline ("NORA Contract"). The Company disputed both of these findings. (Audit Report, pp. 13-19.) Shortly thereafter, the Authority granted the CAPD's petition to intervene and convened a contested case to determine whether the Company's objections to the two findings within the audit should be sustained. (5/9/02 Order Establishing Procedural Schedule, p. 1.)

In July 2002, the CAPD filed a motion for summary judgment as to the first disputed finding that the Company should not be able to retain its $526,265 share of the savings resulting from the discounted transportation contracts it negotiated. (CAPD's 7/19/02 Mot. for Summ. J., p. 1.) That same month, the TRA Staff filed a similar motion for summary judgment as to both the audit finding regarding discounted transportation contracts, as well as the audit's disallowance of savings from the Company's NORA Contract. (TRA Staff's 7/31/02 Mot. for Summ. J., p. 1.)

As part of its examination and hearings on the original implementation of the PBR plan, the TRA hired the independent consultant that had previously served as the TRA's prudency auditor for gas utilities, Frank Creamer, to review Atmos' performance during the experimental PBR period and make recommendations for the structure of the permanent PBR plan. (10/21/02 Affidavit of Frank Creamer, ¶ 4.) After receiving the summary judgment motions in the Audit Case, Atmos consulted with Mr. Creamer. (Id. at ¶ 6.) Mr. Creamer agreed that Atmos should be able to share in savings from both the discounted transportation contracts and the NORA Contract, and submitted an affidavit explaining the proper treatment of both under the current PBR plan. (Id. at ¶¶ 7-9.)

Prior to the summary judgment briefing process, the parties engaged in substantive settlement negotiations, and conducted discovery on the bases for the summary judgment motions filed by the TRA Staff and the CAPD. (4/1/03 Order on Motions for Summ. J., p. 13.) A hearing on the summary judgment motions was held on October 24, 2002. (Id.) On April 1, 2003, the hearing officer found that there were disputed issues of material fact in the case, and denied both motions for summary judgment. (Id. at pp. 13-14.) At that point, the parties began working toward settlement of the case through mediation

B. ***The TIF Tariff Case (Docket No. 02-00850).***

On August 9, 2002, while the parties conducted discovery in the Audit Case on the summary judgment issues, the Company filed its petition in Docket No. 02-00850 to amend its PBR tariff to add a transportation index factor ("TIF"), which would provide a more detailed and specific method for calculation of savings from discounted transportation contracts. (8/9/02 Petition by United Cities Gas Company to Amend the Performance Based Ratemaking Mechanism Rider to Its Tariff, p. 1.) The Company's petition states that it was filed without waiving the Company's objections, defenses and positions taken in the pending Audit Case. (Id.) The CAPD intervened in the tariff filing, and the TRA twice suspended the effective date of the TIF tariff pending the resolution of the disputed issues in the Audit Case for the 2000-2001 plan year (9/17/02 Order Suspending Tariff for 90 Days; 4/9/03 Order Suspending Tariff for Additional 90 Days.)

Three subsequent PBR plan years have ended during the time the parties have been litigating the 2000-2001 plan year in the Audit Case. The 2001-2002 plan year ended on March 31, 2002; on March 31, 2003, the 2002-2003 plan year concluded; and March 31, 2004 marked the end of the 2003-2004 plan year. Pursuant to an agreement with the parties, the Company has postponed the filing of its quarterly and annual PBR reports for the 2001-2002, 2002-2003, and 2003-2004 plan years until a ruling in the Audit Case resolves the parties' dispute regarding the standards that should be applied to those years. (Hearing Trans. Vol. II, pp. 87-88 (Testimony of Pat Murphy).)

C. ***Settlement Attempts.***

Settlement negotiations between the parties began shortly after the CAPD intervened in the Audit Case in May 2002. (4/1/03 Order on Motions for Summ. J., p. 13.) A few months later, during the summer of 2002, it appeared the parties were close to an agreement to resolve both dockets. Atmos had agreed to withdraw its objections to the 2000-2001 audit and refund to consumers all the $627,212 in savings from that year it had already recouped, plus interest, in exchange for implementation of the TIF tariff going forward.[3] (5/21/04 Resp. of Atmos to the CAPD's Objections to the Mot. for App. of Settlement Agrmt., pp 2-4.) Atmos and the Staff were in agreement on all of the settlement terms. The CAPD agreed with the terms of the settlement, but would not agree to an effective date of April 1, 2001 for the new TIF tariff. (Id.) The CAPD insisted that, in addition to refunding all transportation savings for the 2000-2001 audit year, Atmos also forego recovery of transportation savings for the 2001-2002 plan year, which would result in an additional loss to the Company of approximately $800,000. (Id.) The CAPD's reasoning was that even though Atmos had not yet filed its annual report for 2001-2002, using the new TIF tariff for the first plan year following the audit year would amount to impermissible retroactive ratemaking. (Id.) At the time of the settlement negotiations in the summer of 2002, the CAPD would, however, agree to an effective date of April 1, 2002 for implementation of the revised transportation calculations of the TIF tariff. (Id.) Since the CAPD was not in total agreement with the settlement, the Staff elected not to finalize the agreement at that time. (Id.)

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[3] The CAPD waived any confidentiality these settlement negotiations may have had by revealing the content of the negotiations in previous filings in this docket (See CAPD Mot for Extension of Time to Respond to Mot to Consolidate and for Approval of Settlement Agrmt , p 6) Ray v Richards, 2001 WL 799756 at *10 (Tenn Ct App July 17, 2001) (noting that "Tennessee has long recognized a 'good-for-the-goose, good-for-the-gander' rule that if a party opens the door for the admission of incompetent evidence, he is in no plight to complain that his adversary followed through the door thus opened ") (internal citations omitted)

Settlement negotiations continued as the parties engaged in extensive discovery. In June 2003, the parties agreed to mediate both cases in front of Chairman Tate. (See CAPD's 6/19/03 Mot. for Leave to Submit Pre-Mediation Stmt., p.1.) At that time, the only objection the CAPD was asserting to the proposed settlement was its position that an April 1, 2001 effective date for the TIF would constitute retroactive ratemaking. As such, Chairman Tate asked that both parties set forth their positions on that issue, including case cites, in mediation position statements that would not be shared with the opposing side. (See id.) Before the mediation, the CAPD had taken the position it ***would*** agree to the settlement proposal if the effective date of the TIF were made April 1, 2002, which would force the Company to forego savings for two plan years - the 2001-2002 audit year (approximately $600,000 in savings) and the 2001-2002 plan year (approximately $800,000 in savings). (5/21/04 Resp. of Atmos to the CAPD's Objections to the Mot. for App. of Settlement Agrmt., pp. 2-4.)

At the mediation, the CAPD surprised the parties by announcing it was retreating from its earlier position. The CAPD stated that since so much time had passed since the last settlement discussions, the CAPD's position was now that the effective date of the TIF must be April 1, 2003, not April 1, 2002. The CAPD's new position would force the Company to forego an additional plan year's savings (approximately $760,000 for the 2002-2003 plan year) for a total of not two, but three plan years worth of savings the Company would not recover, which would require the Company give up over $2 million. (Id.) During the mediation, the CAPD steadfastly refused to entertain any settlement proposal that required less than the Company's full relinquishment of the over $2 million in savings from all three plan years. (Id.) As a result, no settlement was reached at the mediation.

In September 2003, settlement discussions resumed again. The CAPD agreed in principal to an effective date of April 1, 2001 for the TIF tariff (the original date proposed by the Company), provided the Company agreed to adjust the percentage of shared savings downward and that the TIF would be sunset after 4 years and re-examined at that time. (Id.) Settlement discussions broke down when the CAPD abruptly demanded that Atmos adjust the sharing percentages even lower, to a level which would essentially gut the Company's share of savings. (Id.) All settlement offers were either rejected or withdrawn at that time.

D. ***Atmos and TRA Staff's Joint Proposal to Resolve Both Dockets.***

Having been unable to obtain the CAPD's agreement, despite repeated and prolonged settlement discussions, and faced with the prospect of more years of financial uncertainty and protracted litigation with the CAPD, the TRA Staff and the Company presented a joint proposal to the hearing officer on March 8, 2004 that would resolve the issues in the Audit Case, and set the issues in the TIF case for final resolution by hearing. (3/8/04 Mot. to Consolidate and for Approval of Settlement, p. 3.) The proposal contained in the joint motion reflected substantially the same agreement the Staff and Company reached two years earlier in the summer of 2002: the Company would withdraw its objections in the Audit Case and refund the entire $627,000 in savings it had recovered (plus interest), and proceed, with the support of the Staff, on the TIF case only. (Id. at p. 3 and Ex. 1.) Since the Company was willing to withdraw all of its objections and accept the 2000-2001 audit as filed, the proposal rendered the issues in the Audit Case moot and would have presented the TIF tariff to the Authority for approval so that the CAPD could finally make its substantive objections known and a final determination could be reached. (Id.)

The CAPD urged the Authority to summarily deny the joint motion, even though the CAPD had yet to state any substantive objections to the merits of the proposal, on the grounds that the CAPD needed a full opportunity for discovery before responding.[4] (CAPD's 3/26/04 Mot. for Extension of Time to Resp. to the Mot. to Consolidate, pp. 4-5.) Staff and Atmos agreed to allow the CAPD to submit further discovery requests, and the CAPD's motion for an extension of time to conduct discovery was granted. (4/2/04 Order Granting Mot to Consolidate and to Approve Settlement Agrmt. in Part, pp. 4-5.) After receiving the parties' discovery responses, the CAPD then argued that it should be excused from stating its objections to the proposal because Atmos and the Staff had failed to reveal enough information with regard to the standards to be applied and the grounds for the joint motion. (CAPD's 5/12/04 Mot. to Compel, p. 6.) The hearing officer rejected the CAPD's argument and ordered the CAPD to file a response stating its objections to the merits of proposal contained in the joint motion filed by the Staff and Atmos The hearing officer also set the matter for a full hearing on the merits. (5/13/04 Order Amending Procedural Schedule, pp. 4-5.)

Finally, in its brief filed May 17, 2004, the CAPD, for the first time stated its objections to the merits of the proposed TIF tariff beyond the previous assertion that an April 1, 2001 effective date constituted retroactive ratemaking. As one of its objections, the CAPD insisted that the TIF amendment could not be approved for the 2001-2002 plan year going forward until Atmos first prevailed in having its objections to the audit of the previous plan year sustained, which the CAPD admitted was the heart of the issue in the Audit Case. (CAPD's 5/17/04 Objections To The Mot. Filed By Atmos and TRA Staff, p. 9.) The CAPD claimed that Atmos should be required to successfully establish that transportation savings were already provided for in the original PBR plan before an amendment providing for transportation savings could be added to the PBR plan.

[4] The CAPD did not object to the consolidation of Docket No 01-00704 and Docket No 02-00850 (CAPD's 3/26/04 Mot for Extension of Time to Resp to the Mot to Consolidate, p 1)

(Id.) Ignoring the fact that the Company's agreement to withdraw its objections in the Audit Case gave the CAPD the full extent of what they were seeking - a full refund of all disputed amounts, plus interest, to the consumers - the CAPD argued that the proposal deprived it of the opportunity for unspecified discovery and a hearing on the merits in ***both*** the Audit Case and the TIF case. (Id.) The CAPD's brief did not explain how the proposal would deprive it of the right to discovery and a hearing, since the Company's agreement to withdraw all of its objections to the audit resolved the docket in the CAPD's favor and left nothing to discover or hold a hearing about. (Id.) The CAPD's protestations regarding being deprived of discovery and a hearing in the TIF case were equally as puzzling, given the fact that the hearing officer's procedural schedule gave the CAPD the discovery it requested and set the TIF matter for a full hearing on the merits on June 8, 2004. (5/13/04 Order Amending Procedural Schedule, pp. 4-5.) At the hearing, the hearing officer denied the Staff and Company's proposal to resolve both dockets because the CAPD was not a party to the motion. (Trans. of 6/8/04 Hearing.)

In August, the hearing officer set both dockets for hearing on October 19, 2004. (8/12/04 Order Modifying Procedural Schedule, pp. 3-4.) The procedural schedule provided for the filing of direct and rebuttal testimony, as well as additional discovery. (Id.)

E. ***The October 19, 2004 Hearing.***

The parties simultaneously submitted pre-filed direct testimony on June 30, 2004. Atmos submitted the direct testimony of Pat Childers, Atmos Vice President of Rates and Regulatory Affairs; John Hack, Atmos Director of Gas Supply Planning; and expert witness Frank Creamer. The CAPD submitted the direct testimony of analyst Dan McCormac and economist Dr. Stephen Brown. The Staff submitted the direct testimony of TRA financial analyst Pat Murphy.

After an opportunity for post-testimony discovery, Atmos and the CAPD submitted pre-filed rebuttal testimony of those same witnesses on October 5, 2004. The hearing in both dockets was held on October 19, 2004.

At the hearing, the pre-filed direct and rebuttal testimony of each witness was admitted into the record of the proceedings, and the parties and TRA advisory staff were given the opportunity to cross-examine the witnesses. (Hearing Trans. Vol. I, pp. 6-7.)

III. <u>ATMOS IS ENTITLED TO SHARE IN THE SAVINGS FROM NEGOTIATED TRANSPORTATION DISCOUNTS UNDER THE TERMS OF THE CURRENT PBR PLAN (DOCKET NO. 01-00704).</u>

A. *Atmos Made Extraordinary Efforts to Negotiate the Discounted Transportation Contracts.*

Before 1999, Atmos' transportation contracts were priced at the maximum rate allowed for each particular pipeline by the Federal Energy Regulatory Commission (the "maximum FERC rate"), which was standard throughout the industry. (Direct Test. of John Hack, p. 1.) Because of the incentives contained within the Company's PBR plan that allow Atmos to share in savings from avoided costs, in 1999 when Atmos began to receive notices that its transportation contracts were up for renewal, Atmos responded by aggressively pursuing discounts for those contracts. (<u>Id.</u>; Hearing Trans. Vol. I, pp. 27-28, 34 (Test. of John Hack).)

Atmos devoted a substantial amount of resources to the negotiation of the transportation discounts. (Hearing Trans. Vol. I., pp. 34-35 (Test. of John Hack).) To prepare for the initial meetings with the pipelines, Atmos researched the availability, cost and engineering viability for numerous alternative sources of transportation, including moving its transportation business to Texas Eastern Transmission, Evan Energy, or Tengasco, or shifting as much as two-thirds of its supply to the Columbia Gulf pipeline. (<u>Id.</u> at p. 31.) Atmos then used the information it had gathered as leverage to negotiate discounts for its existing transportation contracts. (<u>Id.</u>)

The discounts were not just available for the asking. (Direct Test. of John Hack, p. 2.) The negotiations were difficult and protracted. (Hearing Trans. Vol. I, pp. 32-33 (Test. of John Hack).) John Hack, Atmos' Director of Gas Supply, together with his supervisor Gordon Roy, Vice President of Gas Supply, negotiated the contracts. (Id. at p 28.) Mr. Hack testified in great detail regarding the negotiations he conducted with each of Atmos' three pipeline carriers, Columbia Gulf, East Tennessee Gas, and Tennessee Gas Pipeline. (Id. at pp. 27-35.) The negotiations with Columbia Gulf involved five or six one to three-hour meetings with Atmos' account representative Pete Bastram over a period of eight months, with numerous phone calls in between. (Id. at pp. 28-29.) The East Tennessee negotiations also involved five or six meetings and numerous phone calls with account representative Bill Wickman over an approximate eight-month period. (Id. at pp. 29-30.) The negotiations with Tennessee Gas Pipeline, which represented roughly 50% of Atmos' transportation dollars in Tennessee, lasted for over year, and involved many meetings with various Tennessee Gas Pipeline personnel. (Id. at pp. 30-31.) The final meeting took place in Houston, with numerous Atmos and Tennessee Gas representatives present, including Tennessee Gas Pipeline Vice President Steve Beasley. (Id. at p. 30.)

The testimony of former TRA consultant Frank Creamer confirmed the difficult nature of the negotiations and the extraordinary effort required to obtain the discounts. Mr. Creamer noted that as a whole, Atmos has been unsuccessful in obtaining discounts on the majority of the pipelines it contracts with. (Direct Test of Creamer, p. 9) None of the six pipelines that serve Atmos' Tennessee territory have discounts on all contracts, and only three of those six pipelines offer discounts at all. (Id.) Of the 16 contracts Atmos holds on its Tennessee territory, 11 are undiscounted and priced at the maximum FERC rate. (Id.) Mr. Creamer confirmed, through his own investigation, that Atmos' experience was consistent with that in the industry as a whole.

(Hearing Trans. Vol. II., p. 73 (Test. of Frank Creamer).) The discounts have become even more difficult to obtain due to the fact pipeline capacity is now more fully subscribed. (Hearing Trans. Vol. I., p. 33 (Test. of John Hack).) As a result, it appears Atmos will lose its discount on at least one of the pipeline contracts it previously negotiated. (Id.)

By November of 2000, Atmos had successfully negotiated discounts on the three major pipelines serving Atmos' Tennessee area, which represented a fairly significant discount to the Company's transportation costs. (Direct Test. of John Hack, p. 2) Mr. Hack testified that Atmos would not have undertaken the extraordinary effort it did without the motivation of the sharing of the savings under the PBR plan. (Hearing Trans. Vol. I, pp. 34-35 (Test. of John Hack).)

B. ***Atmos Met With TRA Staff to Inform Them of the Discounts It Had Negotiated.***

Shortly after successfully negotiating the discounted transportation contracts for the Tennessee area, Atmos contacted Mike Horne, then Chief of the TRA Energy and Water Division, to request a meeting between Atmos representatives and Staff. The purpose of the meeting was to discuss the treatment of the newly negotiated transportation discounts under the Company's PBR plan. (Direct Test. of Pat Childers, p. 2; Direct Test. of John Hack, p. 3.)

The meeting was held on January 31, 2001, at the TRA offices. Mike Horne attended the meeting, together with TRA Staff members Pat Murphy and Dave McClanahan. (Direct Test. of Pat Childers, p. 2; Direct Test. of John Hack, p. 3.) Atmos had several representatives at the meeting, including Pat Childers, then Manager of Rates and Regulatory Affairs; her supervisor, Attorney Mark Thessin, then Vice President of Rates and Regulatory Affairs; Alicia Rye, Rate Analyst; and Ms. Rye's supervisor, Bob Cline, Manager of Rate Administration. (Direct Test. of Pat Childers, p. 2; Direct Test. of John Hack, p. 3.) Atmos also flew in two individuals from its home office in Dallas to attend the meeting: Patti Dathe, Gas Supply Analyst, and John Hack, Director of Gas Supply Planning (Direct Test. of Pat Childers, p. 2; Direct Test. of John Hack, p. 3.)

At the January 31 meeting, the Atmos representatives explained that, motivated by the PBR incentive provisions, the Company had just completed successful negotiations to obtain discounted transportation rates from Tennessee area pipelines. (Direct Test. of Pat Childers, pp. 2-4; Direct Test. of John Hack, pp. 3-5.) Atmos provided all of the attendees with a packet of information which listed a breakdown of the savings. (Direct Test. of Pat Childers, pp. 2-4 and Ex. 1; Direct Test. of John Hack, pp. 3-5 and Ex. 1.) Atmos explained that the savings from the negotiated discount contracts would be considered avoided costs under the PBR plan, and consequently, Atmos would be able to share in those savings under the plan's Gas Procurement Incentive Mechanism. (Direct Test. of Pat Childers, pp. 2-4; Direct Test. of John Hack, pp. 3-5.) The packet of information Atmos provided at the meeting also demonstrated how the savings would be calculated under the PBR plan. (Direct Test. of Pat Childers, pp. 2-4 and Ex. 1; Direct Test. of John Hack, pp. 3-5 and Ex. 1)

At the meeting, Atmos walked through the fact that the transportation discount savings would be calculated by subtracting the negotiated rate from the maximum FERC rate for that particular pipeline. (Direct Test. of Pat Childers, pp. 2-4 and Ex. 1; Direct Test. of John Hack, pp. 3-5 and Ex. 1.) Atmos also explained that the monthly savings would be added together to reach a total annual savings, which Atmos would be able to share in according to the percentages outlined in the PBR incentive mechanism. (Direct Test. of Pat Childers, pp. 2-4 and Ex. 1; Direct Test. of John Hack, pp. 3-5 and Ex. 1.) Atmos informed the Staff at the meeting that the Company would begin using the demonstrated calculation in future quarterly reports, due in the upcoming months. (Direct Test of Pat Childers, pp. 2-4; Direct Test. of John Hack, pp. 3-5.)

The response from the Staff at the January 31 meeting was positive. (Direct Test. of Pat Childers, pp. 2-4; Direct Test. of John Hack, pp. 3-5.) The TRA Staff members actively participated in the meeting and asked numerous questions. (Direct Test. of Pat Childers, pp. 2-4; Direct Test. of John Hack, pp. 3-5.) After Atmos finished its presentation, Atmos asked the Staff what they thought. (Direct Test. of Pat Childers, pp. 2-4; Direct Test. of John Hack, pp. 3-5.) The Staff indicated that they agreed with Atmos' position that the savings from the negotiated transportation discounts were included within the avoided costs provisions of the PBR plan, and that they accepted Atmos' proposed method of calculating and reporting the savings. (Direct Test. of Pat Childers, pp. 2-4; Direct Test. of John Hack, pp. 3-5.) The Atmos representatives exited the meeting believing that the Company's recognition of the income from the shared savings was not an issue, and that the Company was not at risk for disallowance unless the Company heard otherwise from the Staff. (Direct Test. of Pat Childers, pp 2-4; Direct Test. of John Hack, pp. 3-5.) At no point during the January 31 meeting did the Staff give any indication that Atmos could not rely on the Staff's statements, or make any suggestion that Atmos needed to take any further action before proceeding with its proposed reporting and calculations. (Direct Test. of Pat Childers, pp. 2-4.; Direct Test. of John Hack, pp. 3-5.)

On March 1, 2001, just one month after the meeting with Staff, Atmos filed its quarterly report for the period of time from October to December 2000. In this quarterly report, Atmos calculated and reported the savings from the negotiated discount transportation contracts just as it said it would at the January 31 meeting. (Direct Test. of Pat Childers, pp. 5-6 and <u>Exs. 2-3</u>.) Staff made no objections to this quarterly report, either written or oral. (<u>Id.</u>; Hearing Trans. Vol. II, p. 79 (Test. of Pat Murphy).) On May 31, 2001, Atmos filed its quarterly report for January through March 2001, the final quarter of the 2000-2001 plan year. (Direct Test. of Pat Childers, pp. 5-6 and Exs. 2-3.) Again, Atmos calculated and reported the transportation savings in precisely the same manner. (Id.) Again, Staff made no objections, either written or oral, to this quarterly report. (Direct Test. of Pat Childers, pp. 5-6; Hearing Trans. Vol. II, p. 79 (Test. of Pat Murphy).)

C. *The Staff Approved the Company's Method of Calculating Savings, and the Findings of the Audit Are Barred by the Doctrine of Estoppel.*

Just one month after the meeting with the Staff, Atmos filed its quarterly report for the period of time from October through December 2000, and as promised in the January 31 meeting, Atmos reported the savings resulting from the negotiated discounted contracts, and calculated that savings as the difference between the negotiated rate and the maximum FERC rate. (Direct Test. of Pat Childers, pp. 5-6 and Exs. 2-3.) Atmos took pains to bring the newly reported savings to the Staff's attention and calculate them in the simplest, most straightforward manner possible. (Id.) Therefore, Atmos did not try to hide the transportation cost savings, but instead separated the transportation costs in a separate column in the quarterly report so there could be no confusion as to how the savings were calculated. (Direct Test. of Pat Childers, p. 5.) At the time, Atmos thought that the end mathematical result would be the same regardless of whether the transportation costs were calculated as part of the total gas commodity costs or included in their own separate column. (Id.) Since Atmos thought the end results would be identical, it chose to highlight the additional savings for the TRA Staff by including a separate column for the transportation savings. (Id.)

Atmos relied on the provision in the tariff requiring the TRA staff to object to the quarterly reports within 180 days, and assumed that the TRA staff would notify the Company if it had any objection to the calculation method used in the quarterly report. (Id.) When no objection, either written or oral, was forthcoming, Atmos again used the same method of calculation in its May 31, 2001 quarterly report, again, without objection of any sort whatsoever from the Staff. (Id.; Hearing Trans. Vol. II, p. 79 (Test. of Pat Murphy).) Accordingly, pursuant to the tariff (Sheet No. 45.6), Atmos' incentive plan account is deemed in compliance with the provisions of the PBR for the periods represented by the quarterly reports (October – December 2000 and January - March 2001).

The Staff and the CAPD have argued previously that the tariff only requires the Authority to notify Atmos of exceptions to annual reports, and that the Staff has no duty to notify Atmos of exceptions to the quarterly reports. (CAPD 7/17/02 Memo. in Supp. of Mot. for Partial Summ. J., p. 15; Staff 7/31/02 Memo. in Supp. of Mot. for Summ. J., pp. 29-30.) This is contrary to the plain meaning of the specific language in the Company's tariff. The tariff specifically provides:

> The Company will file calculations of shared savings and shared costs quarterly with the Authority not later than 60 days after the end of the quarter and will file an annual report not later than 60 days following the end of the plan year. Unless the Authority provides written notification to the Company within 180 days of ***such reports***, the Incentive Plan Account shall be deemed in compliance with the provision of this Rider.

(Tariff Sheet 45.6) (emphasis added.) This language requires Atmos to file annual ***and*** quarterly reports, and then states that the Incentive Plan Account will be deemed in compliance unless the Authority objects to ***such reports*** within 180 days. If the Authority's obligation to object only applied to the annual report, the plural would not have been used.

The Staff and the CAPD have also argued previously that legal obligations cannot be imposed upon government agencies through estoppel where there is no affirmative act to induce reliance. (CAPD 7/17/02 Memo. in Supp. of Mot. for Partial Summ. J., p 18; Staff 7/31/02 Memo in Supp. of Mot. for Summ. J., p. 31.) This argument misses the point in two respects. First, it is not the doctrine of estoppel which imposes a legal obligation on the Staff, it is the binding regulation contained within the tariff, which has been approved and accepted by the Authority. Second, the Staff did not merely acquiesce to Atmos' filings – it met with Atmos representatives, actively participated in that meeting, and indicated to Atmos that it agreed and approved of Atmos' position and proposed reporting and calculation methods. Atmos relied on these actions, and booked as income the savings resulting from the discounted contracts. (Hearing Trans. Vol. I, pp. 60-61 (Test. of Pat Childers).) The Staff's actions indicate much more than passive acquiescence – the Staff took affirmative action that clearly induced Atmos to act to its detriment. As such, the Staff is now barred from taking an inconsistent position and contesting both the inclusion of the transportation savings as avoided costs under the PBR and the method Atmos used in its quarterly and annual reports to calculate the shared savings. See Bledsoe County v. McReynolds, 703 S.W.2d 123, 125 (Tenn. 1985) (holding that government may be estopped where "public body took affirmative action that clearly induced a private party to act to his or her detriment").

D. ***The Savings From the Transportation Discounts Are Captured Under the Current PBR Plan Through the Application of the Transportation Cost Adjuster.***

The PBR plan provides for consideration of transportation cost savings through the transportation cost adjuster in the Gas Cost Commodity mechanism. (Direct Test of Frank Creamer, p. 10.) As noted earlier, the Gas Cost Commodity mechanism measures Atmos' performance against a benchmark that consists of three published market indexes ***and transportation cost adjuster.*** Specifically, the PBR plan provides that "[f]or city gate purchases, these indexes will be adjusted for the avoided transportation costs that would have been paid if the upstream capacity were purchased versus the demand charges actually paid to the supplier." (PBR Tariff at Sheet 45.2.) The benchmark average index for long-term city gate purchases should be adjusted by adding the appropriate avoided pipeline transportation cost to the average index price of gas. (Direct Test. of Frank Creamer, p. 10.) The avoided pipeline transportation cost should be calculated by comparing Atmos' actual transportation costs for each purchase to the maximum approved FERC rate for firm, long-term transportation contracts published for each particular pipeline.[5] (Id.)

Both the Staff and the CAPD disagree with Atmos' interpretation of the PBR plan and argue that the transportation discounts Atmos has negotiated are excluded from the PBR plan altogether. While the parties disagree as to the end result, there are several points on which all parties are in agreement. These points of agreement include the following:

1. The TRA's intent in implementing the PBR plan was to avoid the necessity of prudency audits by putting incentives in place that span the entire spectrum of the Company's gas purchasing activities necessary to purchase, store, and deliver gas to the end consumer, including transportation. (Hearing Trans. Vol. II, pp. 99-100 (Test of Dan McCormac); Staff 7/31/02 Memo. in Supp. of Mot. for Summ. J., pp. 10, 22-23; CAPD 7/17/02 Memo. in Supp. of Mot. for Partial Summ. J., p. 18.)

2. The PBR is intended to cover the total cost of gas, which includes both the commodity cost and the transportation cost to move the gas from its source to the city gate. (Hearing Trans. Vol. II, p. 93 (Test. of Dan McCormac); Hearing Trans. Vol. II, pp. 83-84 (Test. of Pat Murphy).)

3. The savings the Company shares in under the PBR are determined by comparing the Company's purchases to a basket of market indices. These market indices ***do not*** include the downstream transportation costs Atmos incurs to transport the gas from the pipeline receipt point to the city gate.[6] (Hearing Trans. Vol. II, p. 92 (Test. of Dan

[5] As discussed in more detail in Section IV below, this is how transportation savings from the Company's NORA Contract were calculated during the PBR experimental period

[6] Early on in the lengthy history of this docket, the CAPD, specifically, its expert witness Dr Stephen Brown, took the position that the commodity market indices ***do*** include allowance for downstream transportation costs (CAPD's 7/17/02 Mem in Supp of Mot for Partial Summ J , p 7 (stating that "the indices already included the effect of transportation prices "), CAPD's 9/6/02 Resp to First Data Req. from United Cities, p 3 (stating, in response to a request to state the basis for its claim, that "the Attorney General does not have specific factual documentation that

McCormac; Hearing Trans. Vol. II, pp. 83-84 (Test. of Pat Murphy).)

4. The purpose of the transportation cost adjustor is to allow for an apples-to-apples comparison between city gate purchases (which do include downstream transportation costs) and the market indices used as a benchmark (which do not include downstream transportation costs). (Hearing Trans. Vol. II p. 94 (Test. of Dan McCormac); Direct Test. of Dr. Stephen Brown, p. 15; Hearing Trans Vol. II, pp. 80-84 (Test. of Pat Murphy).)

5. If the transportation costs are wholly excluded from the PBR, as urged by the CAPD, the TRA would have no choice but to perform a yearly prudency audit to determine the reasonableness of the Company's transportation activities. (Direct Test. of Dan McCormac, p. 6[7]; Rebuttal Test. of Dr. Stephen Brown, p. 25; Staff's 5/21/04 Resp. to the CAPD, p. 13.)

Given this list of agreed points, the real dispute in this matter boils down to two discrete issues:

1. Are Atmos' purchases city gate purchases?

2. If Atmos' purchases are city gate purchases, should the avoided transportation costs be calculated by subtracting the actual transportation costs from the maximum FERC rate?

Atmos answers both of these questions in the affirmative. The CAPD insists the answer to both questions is no. The Staff takes the position that the tariff provides no guidance on the proper

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categorically states that transportation prices are included in the indices since there is no documentation available in the industry that specifically states that transportation prices are included in the indices, however it is a fact that is widely recognized by UCG and others within the industry and common knowledge ")) The CAPD has since abandoned its earlier position, and now agrees that the indices do not include any allowance for downstream transportation costs (Hearing Trans Vol II, p. 92 (Test of Dan McCormac)

[7] Mr McCormac actually proposes that the TRA conduct a complete prudency audit, not just of Atmos' transportation procurement, but of all aspects of Atmos' gas, transportation, storage and capacity activities, including planning, documenting, management and operations (Direct Test of Dan McCormac, p 6, CAPD's 9/1/04 Resp to Atmos' Post-Test Disc Req , pp 12-14) Mr McCormac's embrace of prudency audits as the preferred method of regulation is not surprising, given his vehement opposition to the PBR plan from its inception as an "illegal scheme " (See Hearing Trans Vol II, pp 106-07) Mr McCormac was the head of the TRA Energy and Water Division when the Audit Report at issue in this matter was issued (Hearing Trans Vol II, pp 108-09)

definition of city gate, but that the maximum FERC rate is an appropriate way to calculate avoided transportation costs. (Hearing Trans. Vol. II, pp. 81-84 (Test. of Pat Murphy).) As discussed more thoroughly below, the evidence presented supports Atmos' position on these two issues.

1. **Atmos' purchases are city gate purchases.**

The evidence presented in this matter demonstrates that the purchases at issue are indeed city gate purchases, as that term is used in the PBR tariff. All the parties agree that if the purchases are city gate purchases, it is necessary to adjust the market indices through the application of the transportation cost adjustor in order to determine if the Company has earned savings from the purchases. (Hearing Trans. Vol II, p. 94 (Test. of Dan McCormac); Direct Test. of Dr. Stephen Brown, p. 15; Hearing Trans. Vol. II, p. 80 (Test. of Pat Murphy).)

The term "city gate" refers to any location where Atmos' distribution system connects to one of the gas pipelines serving the Tennessee area. (Hearing Trans. Vol. I, pp. 36-37 (Test. of John Hack); Direct Test. of Frank Creamer, p 5.) There are approximately 20 different city gates for Atmos' Tennessee system. (Hearing Trans. Vol. I, pp. 36-37 (Test. of John Hack).) Atmos has the option of purchasing gas at a pipeline receipt point and then arranging for transportation of that gas to the city gate, or purchasing the gas directly at the city gate. (Id.) All the purchases at issue in this docket were made at the city gate. (Id.)

Atmos makes its gas purchases through its purchasing agent, Woodward Marketing. (Id.) During the original PBR proceedings, the TRA found that Atmos' contract with Woodward, and in particular, the contract price, "is good, if not exceptional, and that the contract benefits Tennessee consumers, as well as United Cities." (Phase 2 Order, p. 20.) Atmos' contract with Woodward is a requirements contract; Woodward arranges for Atmos' full requirements of gas to be delivered directly to the city gate. (Id at pp 16-17; Hearing Trans Vol. I, pp. 36-37 (Test. of John Hack).)

Atmos does not dictate where Woodward should take delivery of the gas or how the gas should be transported to Atmos' city gate other than stipulating that Woodward meet the requirement in the Company's operational plans to deliver the gas at the lowest cost feasible, taking into consideration both commodity and transportation. (Phase 2 Order, pp. 16-18 (noting that "United Cities' witnesses testified repeatedly that United Cities did not care how Woodward sourced its gas as long as it met the requirements of United Cities' customers as outlined in the Summer and Winter operational plans.").)

Woodward takes delivery of the gas at a particular pipeline receipt point (the Henry Hub point, for example), and then Woodward arranges for that gas to be transported to Atmos' city gate. (Hearing Trans. Vol. I, pp. 36-37 (Test. of John Hack).) As demonstrated by the Woodward invoice admitted into evidence at the hearing in this matter, Atmos pays Woodward a bundled price for the gas that is delivered to the city gate that includes both the commodity charge and the cost for transporting the gas from the receipt point to the city gate (downstream transportation costs). (Id. at pp. 38-40 and Ex. 2.) Because Atmos' purchases are delivered and paid for at the city gate, and are billed through a bundled charge that includes both commodity and downstream transportation costs, Atmos' purchases are indeed city gate purchases as that term is used in the PBR tariff. Therefore, the transportation cost adjustor must be applied in order to make an apples -to-apples comparison between the costs Atmos pays (which include downstream transportation costs) and the market indices used as the benchmark (which do not include downstream transportation costs).

The CAPD's position with regard to the proper definition of city gate is contained in Mr. McCormac's testimony. The examples of city gate purchases contained in Mr. McCormac's pre-filed testimony are limited to purchases of locally produced gas delivered in Tennessee. (Rebuttal

Test. of Dan McCormac, p. 3.) At the hearing, Mr. McCormac expanded his definition of city gate to include the "rare exceptions" where Atmos purchases interstate gas through a bundled transaction at the city gate that includes both commodity and transportation charges in one bill. (Hearing Trans. Vol. II, pp. 98-99.) Under the most basic definition Mr. McCormac gave of "bundled transaction," Atmos' purchases would qualify as city gate purchases, because, as demonstrated by Mr. Hack's testimony and the Woodward invoice, Atmos pays a bundled price for its gas delivered at the city gate that includes both commodity and transportation charges in one bill.[8]

Mr. McCormac, however, went on to qualify his definition further by stating that a bundled transaction qualifies as a city gate purchase under the PBR tariff only if it is "truly a bundled transaction." (Hearing Trans. Vol. II, p. 99, line 18.) When questioned further, Mr. McCormac could not articulate what standards could be applied to determine whether a transaction was "truly a bundled transaction." Mr. McCormac did, however, reject the use of the invoice to determine whether a purchase is "truly a bundled transaction." (Id. at pp. 103-04.) Mr. McCormac could point to no provisions within the PBR proceedings or the tariff itself which provided any support whatsoever for the limitations he placed on his definition of city gate which would restrict the definition exclusively to purchases of locally produced gas or the "rare exception" purchase which meets his indescribable requirement of "a truly bundled transaction." (Hearing Trans. Vol. II, pp. 100-102.)

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[8] It appears the CAPD may be confused as to the nature of Atmos' gas purchases under the Woodward contract If so, it would not be the first time As part of its opposition to the original PBR plan, the CAPD attacked the validity of the Woodward contract and even went so far as to accuse Atmos of fraud In rejecting the CAPD's argument, the TRA found that "Dr Stephen Brown's testimony indicates that, even though the contract is quite specific, the Consumer Advocate may not have understood the operation of this gas sales contract going into this Hearing " (Phase 2 Order, p 17)

Mr. McCormac did admit that the Company's NORA Contract is an example of a city gate purchase under the PBR tariff. (Hearing Trans. Vol. II, p. 99.) The NORA contract is a long term purchase contract which was included in the PBR program during the experimental period, excluded during the first year of the permanent PBR program as a pre-existing contract, and then added back into the PBR plan when the contract was renegotiated in 2000. (Direct Test. of Frank Creamer, pp. 17-18.) Because the NORA Contract is a combined commodity/transportation contract, it is a bundled transaction: Atmos pays one amount for the gas purchased under the contract that includes both commodity and downstream transportation costs for delivery to the city gate, just as Atmos does for its other purchases through Woodward. (Id.) Because purchases under the NORA Contract allow Atmos to avoid having to pay full rates to transport the gas from a pipeline receipt point farther away from the city gate, the NORA purchases reduce Atmos' downstream transportation costs just as the negotiated discounts at issue in this docket reduce transportation costs. (Rebuttal Test. of Frank Creamer, p. 6.)

When the NORA contract was included in the PBR during the experimental period, the savings resulting from that contract were calculated exactly as Atmos contends the negotiated discounts in this docket should be calculated: because the NORA purchases were city gate purchases, the indices were adjusted through the transportation cost adjustor by calculating the avoided transportation costs (using maximum FERC rate minus actual rate), and adding that amount to the commodity-only market indices before comparing those indices to the purchases to determine savings. (Id.)

Just like the NORA purchases, Atmos' purchases at issue in this matter were delivered and paid for at the city gate. Just like the NORA purchases, Atmos' purchases are billed through a bundled charge that includes both commodity and downstream transportation costs. Therefore, just like the NORA purchases, Atmos' purchases are indeed city gate purchases as that term is used in the PBR tariff Therefore, the transportation cost adjustor must be applied in order to make an apples-to-apples comparison between the costs Atmos pays (which include downstream transportation costs) and the market indices used as the benchmark (which do not include downstream transportation costs).

2. **The avoided costs from the transportation discounts should be calculated using the maximum FERC rate.**

The second point of contention between the parties involves the calculation of avoided costs under the transportation cost adjustor. Atmos contends that the avoided costs from the negotiated transportation discounts should be calculated as they have always been for the NORA purchases - by comparing the actual cost to the maximum FERC rate, which is the market indicator for downstream transportation costs. The CAPD argues that the avoided costs from the negotiated transportation discounts cannot be calculated at all, because there is no published market index compiling market information on downstream transportation costs. The CAPD's position is contrary to the evidence presented in this proceeding.

Taking an extremely strict constructionist view of the PBR tariff, the CAPD argues that because the tariff itself does not expressly refer to "maximum FERC rate," then the maximum FERC rate may not be used as a benchmark to calculate avoided costs under the discounted transportation agreements, despite the fact maximum FERC rate was used to calculate the avoided costs for the NORA purchases during the PBR experimental period. (Direct Test. of Dr. Stephen Brown, p. 25.) The CAPD agrees, however, that the PBR was intended to provide Atmos with an incentive to beat the market in its purchasing activities by comparing Atmos' purchases with a benchmark which serves as a proxy for the market Atmos is rewarded for beating. (Id. at p. 4.)

Because there is no published index for downstream transportation costs, the CAPD concludes that there can be no benchmark. (Id. at p. 25.)

Through the testimony of TRA consultant Frank Creamer, which was not challenged by the CAPD at the hearing, Atmos established that the maximum FERC rate does serve as the market indicator for downstream transportation costs. (Direct Test. of Frank Creamer, pp. 11-12; Hearing Trans. Vol. II, pp. 71-72 (Test. of Frank Creamer).) In addition to recognizing the fact that the maximum FERC rate has historically been used as the benchmark for calculating avoided transportation costs under the NORA Contract, Mr. Creamer also demonstrated through his testimony that: (1) the maximum FERC rate is the market-clearing price for the majority of the firm transportation contracts industry-wide and is the basis for the negotiations of any future discounts; (2) the maximum FERC rate would serve as the benchmark for any prudence review of Atmos' purchases, and (3) the maximum FERC rate has been accepted by other state public utility commission reviews of PBR plans as the appropriate benchmark to measure avoided downstream transportation costs. (Rebuttal Test. of Frank Creamer, pp. 4-5.) TRA Staff agrees with Mr. Creamer's conclusions. (Hearing Trans. Vol. II, pp. 83-84 (Test. of Pat Murphy).)

The CAPD provided no rebuttal to Mr. Creamer's testimony establishing that the maximum FERC rate serves as a proxy for the market for downstream transportation costs[9], choosing instead to rely upon its strict constructionist argument that because maximum FERC rate is not expressly mentioned in the terms of the PBR tariff, it is excluded, regardless of the fact that it was used to calculate savings under the NORA Contract during the experimental period.

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[9] As part of its opposition to the TIF tariff proposed in Docket No 02-00850, the CAPD, through the testimony of Dr Stephen Brown, does make some policy arguments with regard to whether the maximum FERC rate ***should*** be used in the future as a benchmark in the TIF tariff Those arguments are addressed in Section V of this brief

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The CAPD argues that the transportation discounts Atmos has negotiated cannot possibly be included within the PBR plan because the discounts were not a feature of the marketplace when the PBR was implemented almost a decade ago and therefore the discounts were not specifically referenced in the language of the PBR orders or tariffs. (Rebuttal Test. of Dan McCormac, p. 9.) The CAPD agrees, however, that the PBR was intended to span the entire spectrum of the Company's gas purchasing activities necessary to purchase, store, and deliver gas to the end consumer, including transportation. (Hearing Trans. Vol. II, p. 100 (Test. of Dan McCormac).) The CAPD also agrees that the PBR was intended to cover the total cost of gas, which includes both the commodity cost and the transportation cost to move the gas from its source to the city gate. (Phase 2 Order, p. 18; Hearing Trans. Vol. II, p. 93 (Test. of Dan McCormac).) The PBR was intended to provide incentives for the Company to find innovative ways to reduce costs. Contrary to the CAPD's position, the TRA could not be expected to specifically foresee every possible way the Company would find to reach its goal of cost reduction. Instead, the PBR provided a framework for the sharing of savings resulting from all the Company's purchasing activities. Allowing Atmos to share in the savings from the transportation discounts it has negotiated, through the application of the transportation cost adjustor, is consistent with the scope and intent of the original PBR. The TRA should therefore reject the Staff's disallowance of those savings in the audit of the 2000-2001 plan year.

IV. ATMOS IS ENTITLED TO SHARE IN THE SAVINGS FROM THE NORA CONTRACT UNDER THE TERMS OF THE CURRENT PBR PLAN (DOCKET NO. 01-00704).

The Company's NORA Contract covers gas supply from the East Tennessee-NORA gas pipeline. (Audit Report, p. 17 n.32.) All the parties agree that the Company is entitled to share in savings from its NORA Contract under the PBR.[10] (Direct Test. of Frank Creamer, p. 17; Hearing Trans. Vol. II, p. 82 (Test of Pat Murphy); Hearing Trans. Vol. II, p. 130 (Test. of Dan McCormac).) All parties also agree that purchases under the NORA Contract are city gate purchases, as that term is used in the PBR, and that savings from NORA purchases should be calculated using the transportation cost adjustor. (Direct Test. of Frank Creamer, pp. 17-19; Rebuttal Test of Dan McCormac, pp. 11-12; Hearing Trans. Vol. II, p. 82 (Test. of Pat Murphy).) The Staff, however, has challenged the method Atmos used in its 2000-2001 audit filing to calculate transportation cost savings resulting from the Company's NORA Contract because the NORA purchases were not included in the total commodity purchases for each month, but instead were treated as a separate calculation [11] As more thoroughly discussed below, the method Atmos used to calculate savings from NORA in its annual audit filing was previously approved by the TRA.

Purchases under the NORA Contract are bundled transactions containing both commodity and transportation components in the total charges. (Direct Test. of Frank Creamer, p. 17.) The NORA Contract was included within the experimental PBR period, but was removed from the PBR program when the plan was made permanent because the contract pre-dated the existence of the PBR program. (Phase Two Order, pp. 6-7.) The Phase One Order specifically provided that if

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[10] CAPD witness Dan McCormac testified that he disagreed with the TRA's decision to put the NORA contract back into the PBR after it was renegotiated in 2000 (Hearing Trans Vol II, p 130)

[11] Throughout the three years of litigation in this matter, the CAPD has never, in any of its filings, articulated its specific position with regard to whether the NORA purchases should be treated as a separate calculation (See 4/1/03 Order on Mot for Summ J , p 13) (noting that the CAPD had not moved for summary judgment on the NORA issue) The CAPD did not submit any pre-filed or hearing testimony disputing the calculation of the NORA purchases presented by Atmos through the testimony of Frank Creamer As such, the CAPD has waived its right to contest this issue See 6/27/03 Order in In Re Tennessee American Water Company, TRA Docket No 03-00118 (granting CAPD's motion to exclude late filed testimony in light of parties' right to investigate and cross-examine other parties' positions), Lones v Blount County Beer Board, 538 S W 2d 386, 390 (Tenn 1976) (noting that it is fundamental to our law that a party cannot raise a new issue or present a new line of proof that was not addressed in the pleadings or at trial)

the NORA Contract was renewed or renegotiated, Atmos could petition for inclusion of the contract in the PBR mechanism. (Final Order on Phase One, Docket No. 97-01364, Jan. 14, 1999, p. 27.)

During the experimental PBR period, avoided transportation costs from the NORA Contract were calculated the same way Atmos calculated them in its audit filing. (Direct Test. of Frank Creamer, pp. 17-19.) The actual purchase price paid for the transportation component of the transaction was subtracted from the maximum FERC rate to determine the avoided transportation costs that resulted from the contract. (Id.) The savings from the NORA Contract were then calculated through the application of the transportation cost adjustor: because the NORA purchases included both commodity and downstream transportation charges, it was necessary to adjust the commodity-only market indices by adding the avoided transportation costs before comparing the purchase with the indices to determine savings. (Id.)

On September 26, 2000, Atmos filed a petition to re-include the renegotiated NORA Contract in its PBR plan. Submitted with Atmos' petition were attachments which illustrated the proposed separate calculation of the NORA avoided transportation costs, which was the same method of calculation used before the NORA Contract was removed from the PBR. (Id.; Docket No. 00-00844, United Cities Gas Company's Petition Regarding Affiliated Transaction and Request to Include New Agrmt. Covering East Tennessee-NORA Delivery Point, Exs. A to C.)

On November 8, 2001, the Authority entered an order granting Atmos' petition. (Direct Test. of Frank Creamer, p. 17; Audit Report, pp. 17-18.) The Authority's Order specifically provided:

> Upon a ***careful review*** of the petition, ***and of the entire record in this matter***, the Authority approved United Cities' request to include transactions under the new NORA contact in its Incentive Plan.

(Order in Docket No. 00-00844, p. 2) (emphasis added). Neither the Staff nor the Directors nor any third party raised any objection whatsoever to Atmos' proposed calculations with regard to the avoided costs resulting from the NORA Contact. By the Authority's own language, it carefully reviewed both the petition and the entire record in the matter, which included the proposed calculations. If the Authority did not approve of the calculations, it would have stated so in its Order.

The Authority's November 8, 2001 Order specifically stated that the Authority had reviewed the entire record in the case concerning Atmos' petition for inclusion of the NORA Contract, and had decided to grant Atmos' petition In reliance on this opinion, Atmos included the NORA Contract savings in its Incentive Plan Account and booked as income its share of the benefits earned under the PBR program. It was entirely reasonable for Atmos to rely on the Authority's Order, which approved the same method of calculation that was used before the NORA Contract was removed from the PBR. The Authority's Order was an affirmative act which induced Atmos' reasonable reliance to its detriment. The Order constitutes the official legal position of the Authority, which the Staff is estopped to contradict. See Bledsoe County, 703 S.W.2d at 125.

Even if the TRA does not agree that the separate calculation of the NORA purchases has been previously approved by TRA order, there is no dispute among the parties that Atmos is entitled to share in the savings from the NORA purchases, and that those savings should be calculated through the application of the transportation cost adjustor for city gate purchases. In its Audit Report, TRA Staff simply excluded the NORA purchases altogether. (Audit Report, pp. 17-20.) As such, even if the TRA rules that the NORA purchases cannot be treated as a separate transaction notwithstanding the previous order of the TRA, the Audit Report must be amended to include the appropriate calculations for the NORA purchases.

V. <u>THE TIF TARIFF PROPOSED BY ATMOS IS JUST AND REASONABLE AND IN THE BEST INTERESTS OF THE COMPANY AND THE CONSUMERS (DOCKET NO. 02-00850).</u>

As the Company continued to litigate the issues in the Audit Case with regard to the 2000-2001 plan year, there appeared to be no end in sight Because of the dispute with regard to how transportations savings were to be calculated under the PBR, the parties agreed that the Company would not file any quarterly or annual PBR reports, thus leaving the audit years open, until the issue was resolved. (Hearing Trans. Vol. II, pp. 88-90 (Test. of Pat Murphy).) Faced with the prospect of continuing to litigate with the CAPD while successive plan years piled up un-audited, the Company filed a petition in August of 2002, assigned Docket No. 02-00850, that, without waiving the Company's position in the Audit Case that transportation savings are included in the current PBR, proposed an amendment to its tariff to be applied to the plan years subsequent to the Audit Case.

The tariff amendment provides for a more detailed and specific method for calculation of savings from discounted transportation contracts through a transportation index factor ("TIF"). (Direct Test. of Frank Creamer, pp. 20-23) The TIF amendment provides that it will be effective for all PBR reports submitted to the TRA in the future, the first of which being the report for the 2001-2002 plan year which began April 1, 2001. (Docket No. 02-00850, 8/9/02 Petition by United Cities Gas Company to Amend the Performance Based Ratemaking Mechanism Rider to Its Tariff, p 1) According to TRA rules, the tariff filing should have gone into effect 30 days after filing, or on September 9, 2002. (Hearing Trans. Vol. II, pp. 88-89 (Test of Pat Murphy); Tenn. Comp. R. & Regs. 1220-4-1-.04 - .06.) However, the TRA twice suspended the effective date of the amendment to Atmos' PBR tariff Audit Case. (9/17/02 Order Suspending Tariff for 90 Days. p. 1; 4/9/03 Order Suspending Tariff for Additional 90 Days, p. 1.)

A. *The TIF Tariff Provides a Simplified and More Straightforward Method for Calculating Transportation Savings.*

The TIF tariff contains a slightly different and more detailed formula for the calculation of transportation cost savings that more explicitly reflects current market conditions. (Direct Test. of Frank Creamer, pp. 20-23.) The TIF amendment adds a third incentive mechanism to the two existing mechanisms (Gas Commodity Cost and Capacity Release Sales). This third mechanism would be a separate mechanism solely for transportation costs and would be labeled a Transportation Index Factor ("TIF"). (Id.)

The recommended TIF component of the PBR would calculate the amount of savings earned in the Company's transportation purchases by the same method used to calculate savings from NORA purchases in the current PBR: by comparing the actual purchase price to the maximum FERC rate. (Id.) The formula for sharing of savings is different, however. While the current PBR allows the Company to share in 50% of the savings for all purchases that fall below 97.7% of the benchmark (after adjusted for avoided downstream transportation costs), the TIF allocates the Company's monthly transportation savings between the consumers and the Company based on a three -tiered sharing formula:

> a) When the savings are greater than 0% but less than 10% of the standard of performance, the Company is entitled to 30% of the savings, with the consumers retaining the remaining 70% of the savings;
>
> b) When the savings are greater than or equal to 10% but less than 20% of the standard of performance, the Company is entitled to 40% of the savings, with the consumers retaining the remaining 60% of the savings; and

c) When the savings are greater than or equal to 20% of the standard of performance, the savings are shared equally between the consumers and the Company.

(Id.) Atmos' total earnings under the entire PBR plan would be its portion of TIF benefits in addition to its portion of savings under the two existing mechanisms, subject to the earnings cap. (Id.)

B. *The TIF Tariff is Consistent With the Scope and Intent of the Original PBR Plan.*

The TIF tariff proposed in Docket No. 02-00850 is consistent with the intent and scope of the current PBR, and is just and reasonable and in the best interest of the Company and the ratepayers. (Direct Test. of Frank Creamer, p. 22.) As all parties agree, the purpose of the PBR program is to incent proper business decisions and do so in a manner that is not detrimental to the consumer. (Hearing Trans. Vol. II, pp. 99-100 (Test. of Dan McCormac); Hearing Trans. Vol. II, pp. 83-84 (Test. of Pat Murphy); CAPD 7/17/02 Memo. in Supp. of Mot. for Partial Summ. J., p. 18.) As all parties agree, in order to satisfy this design principle, a PBR program must span all gas purchasing and transportation activities. (Hearing Trans. Vol. II, pp. 99-100 (Test. of Dan McCormac); Hearing Trans. Vol. II, pp. 83-84 (Test. of Pat Murphy).) The PBR must also be flexible enough to allow innovation with regard to types of savings obtained. (Direct Test. of Frank Creamer, pp. 22-23.) Without such flexibility, the PBR has a material defect. (Id.) If the Company is permitted to recover savings for only a portion of its gas purchasing and transportation activities, the incentives will be skewed and will not result in the most beneficial decisions for the Company and the ratepayers. (Id.)

The TIF tariff simplifies the PBR calculations by unbundling the transportation cost component of the total delivered cost of gas to the city gate and treating it separately from the commodity costs. (Id.) Transportation costs can then be monitored on a pipeline by pipeline contract basis, thereby simplifying the transportation cost process. (Id.) Should the commodity mechanism of the PBR ever need to be modified due to changes in the highly complex and evolving gas commodity market, such modifications can be made without the necessity of reformulating the entire PBR plan. (Id.)

The TIF tariff is also consistent with the intent, scope, and goals of the PBR plan. (Id.) The Staff and the CAPD admit that unless transportation costs are included in the PBR plan, either through the transportation cost adjustor in the current plan, or through a TIF component, then the TRA will have no choice but to hire a consultant each year to conduct an annual prudency audit examining the reasonableness of Atmos' transportation purchases. (Direct Test. of Dan McCormac, p. 6 ; Rebuttal Test. of Dr. Stephen Brown, p. 25; Staff's 5/21/04 Resp. to the CAPD, p. 13.) This is exactly the type of inefficient and costly regulatory activity that the TRA has determined, unanimously, is not in the best interests of consumers. (Phase 2 Order, p. 2.)

Consistent with the TRA's desire, in implementing the PBR plan, to avoid costly and inefficient regulatory practices, the TIF tariff will result in a reduction in regulatory costs. (Direct Test. of Frank Creamer, pp. 20-23.) This reduction of costs corresponds to a reduced cost-of-service, which directly benefits the consumer by reducing the corresponding amount of revenue requirements and therefore, consumer rates. (Id.) It also benefits the Company and the TRA by freeing up scarce resources to focus on other regulatory and business issues. (Id.)

The TIF tariff is also consistent with the PBR's intent to ensure that the consumer's cost-of-gas is based fairly on market-based pricing and that the Company is incented to beat that market price. (Id.) The TIF tariff also serves the PBR's goal of ensuring that the Company's gas purchasing activities are focused on reducing the total cost of gas delivered to the city gate, as opposed to maximizing benefits in one component of the PBR at the expense of another. (Id.)

The TRA Staff agrees that the TIF tariff is consistent with the intent and scope of the PBR, and is in the best interest of the Company and consumers. (Hearing Trans. Vol. II, p. 84 (Test. of Pat Murphy).)

The CAPD raises several objections to the TIF tariff, many of which parrot the arguments the CAPD made in opposition to the original PBR plan. Each of the CAPD's objections are discussed separately below. As more thoroughly demonstrated in the following sections, none of the CAPD's objections are well-founded.

C. *The Extraordinary Effort Atmos Undertook to Negotiate the Discounts Justifies the Sharing of Savings.*

The CAPD first argues that Atmos should not be permitted to share in any savings resulting from the transportation discounts it has negotiated, because, according to the CAPD's witness, Atmos did not have to expend any effort to obtain the discounts. (Rebuttal Test. of Dr. Stephen Brown, pp. 1-22.) The CAPD claims the discounts were simply offered to Atmos. (Rebuttal Test of Dr. Stephen Brown, p. 8.) Mr. John Hack, Atmos' Director of Gas Supply Planning, personally negotiated the discounted transportation contracts at issue in this matter. (Hearing Trans Vol. I, p. 17 (Test. of John Hack).) Mr. Hack, who has negotiated transportation contracts with more than 35 different interstate pipeline companies during his many years with Atmos, gave detailed testimony describing the difficult nature of the negotiations and the extraordinary amount of resources Atmos was required to devote to the endeavor. (Hearing Trans. Vol. I, pp. 27-35.) The negotiations with each pipeline lasted anywhere from eight months to a year, required multiple telephone calls and lengthy in-person meetings, which, in the case of the largest volume pipeline, were attended by numerous Atmos and pipeline personnel, including Tennessee Gas Pipeline Vice President Steve Beasley. (Id.)

The testimony of former TRA consultant Frank Creamer confirmed the difficult nature of the negotiations and the extraordinary effort required to obtain the discounts, as demonstrated by the fact that Atmos has been unsuccessful in obtaining discounts on 11 of the 16 contracts serving its Tennessee territory. (Direct Test. of Creamer, p. 9.) Mr. Creamer also testified that he had conducted his own independent investigation, which confirmed that Atmos' experience was consistent with that in the industry as a whole. (Hearing Trans. Vol. II., p. 73.)

The CAPD claims that Mr. Hack and Mr. Creamer are simply not to be believed. The CAPD insists that John Hack, Pat Childers, and Frank Creamer all lied in their descriptions of the motivation for and the conduct of the negotiations. (Rebuttal Test. of Dr. Stephen Brown, pp. 15-18, Hearing Trans. Vol. II, pp. 141-144 (Test. of Dr. Stephen Brown).) CAPD witness Dr. Stephen Brown went as far as to state that he did not believe the negotiations ever took place. (Hearing Trans. Vol. II, p. 142, lines 11-12.) Dr Brown admitted he had no experience whatsoever in negotiating gas or other utility contracts; that he had no personal knowledge of what took place during Atmos' negotiations with its pipeline carriers; and that, unlike Mr. Creamer, he made no effort to contact any individual involved in the industry or any of the numerous individuals involved in the negotiations themselves, even though Dr. Brown attached to his rebuttal testimony a list of pipeline personnel that included the telephone number of at least one individual directly involved in the negotiations with Atmos (Tennessee Gas Vice President Steve Beasley). (Hearing Trans. Vol. II, pp. 110 (Test. of John Hack), pp. 141-144 (Test of Dr. Stephen Brown).)

That Dr. Brown would accuse Ms Childers, Mr. Hack, and Mr. Creamer of lying about events of which he has no personal knowledge or experience, and without bothering to make any investigation whatsoever provides considerable insight into his credibility as a witness. However, the Authority need not rely on that accusation alone in judging the credibility of his testimony. Dr. Brown has taken many positions throughout the course of this matter which have been revealed as unsupported, baseless, and just plain wrong

For example, Dr. Brown claims in his rebuttal testimony that Atmos misrepresented the facts when its stated, in a discovery response, that the pipelines' financial incentive to give Atmos discounts was keeping Atmos as a customer. (Rebuttal Test. of Dr. Stephen Brown, pp. 18-19.) According to Dr. Brown, Atmos' statement is false because the only pipelines Atmos had the option of using when it negotiated the discounted contracts were East Tennessee and Tennessee Gas, which were owned by the same company. (Id.) Dr. Brown is wrong. Atmos was not limited to the East Tennessee and Tennessee Gas pipelines. Atmos had the option of moving its transportation to numerous pipelines other than East Tennessee and Tennessee Gas, including Texas Eastern Transmission, Evan Energy, Tengasco, or Columbia Gulf. (Hearing Trans. Vol. I, p. 31 (Test. of John Hack).) In fact, as part of its preparation for negotiating discounts with East Tennessee and Tennessee Gas, Atmos researched the availability, cost and engineering viability for numerous alternative sources of transportation, and used the information it had gathered as leverage in seeking discounts for its existing transportation contracts. (Id.) Dr. Brown's testimony reveals not only a lack of knowledge about the gas industry, but also a disturbing willingness to make serious accusations without investigation or support.

Dr. Brown also takes issue with the testimony that the financial incentives in the PBR were the driving force that motivated Atmos to expend the effort it did in negotiating the discounts. Dr. Brown disputes that testimony based solely on his conclusion that Atmos has not complied with the incentive compensation component of its PBR tariff. Dr. Brown claims that "[b]ecause Atmos admits it has no record of employee compensation being tied to the PBR, the only reasonable conclusion is that the PBR was not the motivator for such negotiations." (Rebuttal Test. of Dr. Stephen Brown, p. 24.) Dr. Brown's position does not even make sense in theory. According to Dr. Brown, Atmos employees will only perform those tasks they receive a bonus for; if the employees do not receive a bonus directly tied to their success on a project, they simply refuse to make any effort. The reality is that Atmos' gas supply employees' pay is tied to company financial performance, including PBR results.[12] (Hearing Trans. Vol. I, p. 44.) Dr. Brown's argument provides no reason to disbelieve the testimony establishing that the PBR did serve as the motivator for the negotiation of the transportation discounts, but does shed more light on the reliability of his statements as a whole.

Perhaps the most egregious example of Dr. Brown's misuse of facts is the conclusion he draws based on the FTC's January 2000 order requiring El Paso to sell its subsidiary East Tennessee Gas as a condition to El Paso's proposed merger with SONAT, Inc. Dr. Brown claims the FTC order is conclusive proof that Atmos did not have to expend any effort to secure the transportation discounts at issue in this matter. Dr. Brown's conclusions reveal a fundamental misunderstanding of the nature and effect of the FTC order.

As recited in the order, the FTC found, as a result of its investigation, that the proposed merger of El Paso and SONAT would significantly reduce the competition available for pipelines serving eastern Tennessee and northern Georgia. (Hearing Trans. Vol. II, pp. 69-70 (Test. of Frank Creamer); FTC News Release (Sch. 3 to Brown Rebuttal Test.) at pp. 1-2.) Because El Paso

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[12] Atmos stated in its discovery response that "[n]o Atmos employees receive compensation associated with the PBR plan " (See Atmos' 5/10/04 Resp. to Atty Gen 's Disc Req , Int 9) While it is correct that employee compensation is not tied directly to PBR plan results, employees are eligible to receive additional pay based on the Company's earnings per share and net income, which is dependent, in part, on the level of income generated through PBR results (See June 1, 1999 Ltr from M Thessin to TRA, filed in Docket No 97-01364, attached hereto as Exhibit A.) In its audit of both the 1999-2000 and 2000-2001 plan years, the TRA found the above-described compensation program satisfied the incentive compensation requirements of the Company's PBR tariff (Audit Report, p 4)

was essentially buying out it major competitor by merging with SONAT, the FTC ordered El Paso to sell East Tennessee Gas as a condition of the merger. (Hearing Trans. Vol. II, pp. 69-70, 74-76; FTC New Release (Sch. 3. of Brown Rebuttal Test.) at p. 1.) The purpose of the FTC Order requiring El Paso to sell East Tennessee Gas was to preserve the competition that existed in the area prior to the merger. (Id.)

The FTC complaint recites by way of background allegations that, prior to entering into merger discussions with SONAT, El Paso was in direct competition with SONAT, through its subsidiary East Tennessee Gas. (Hearing Trans. Vol. II, p. 69 (Test. of Frank Creamer); FTC Compl. (Sch. 1 to Brown Rebuttal Test.) at ¶¶ 32-37.) The FTC complaint also recites, by way of background, that prior to the merger discussions, East Tennessee Gas responded to SONAT's threat to build its own pipeline and by-pass the East Tennessee system by offering reduced rates to local gas distributions utilities in eastern Tennessee. (Id.) Dr. Brown seizes on those background allegations as proof that "Atmos's contracts with ETNG and TGP are the result of El Paso's anti-competitive behavior and the FTC's regulatory cure, which forced El Paso to sell ETNG in January 2000." (Rebuttal Test. of Dr. Stephen Brown, p. 9.)

Dr. Brown's characterization of El Paso's behavior and the FTC's actions is completely backwards. Offering discounts is not illegal or anti-competitive - it is just the opposite. Offering discounts is entirely legal and competitive behavior. (Hearing Trans. Vol. II, pp. 69-70, 74-76 (Test. of Frank Creamer).) The FTC was not punishing El Paso for offering discounts - it was encouraging such activity by ensuring a competitive environment that would give El Paso the incentive to negotiate discounts. (Id.)

The following statement from Dr. Brown's rebuttal testimony demonstrates the extent to which Dr. Brown misconstrues the purpose and effect of FTC action:

> Rather than disallowing the reduced-price contracts, the FTC let the contracts stand. Therefore, in my opinion the FTC forced El Paso to sell ETNG because a forced sale was the only practical way to prevent El Paso from profiting by its anti-competitive behavior without harming gas distributors and consumers. El Paso conferred economic rewards on the distributors to stymie SONAT's plans to compete with El Paso in Tennessee The FTC examined the situation and concluded that competition through the development of a new pipeline that would compete with ETNG was not possible because of El Paso's behavior.

(Rebuttal Test. of Dr. Stephen Brown, p. 10.) Contrary to Dr. Brown's interpretation, the FTC did not want to disallow the reduced-price contracts - it wanted to do just the opposite - encourage the reduced-price contracts. (Hearing Trans. Vol. II, pp. 69-70, 74-76 (Test. of Frank Creamer).) The anti-competitive behavior the FTC was attempting to cure was not the offering of discounts. The anti-competitive behavior was the merger of El Paso's subsidiary into SONAT, one of its major competitors. (Id.) The FTC was not trying to ensure that SONAT could build a new pipeline. Instead, the FTC was trying to preserve the competitive environment that created the incentive for East Tennessee to block that effort through price competition. (Id.)

Dr. Brown not only misinterprets both the factual background and purpose of the FTC action, he also makes unsupported conclusions based on that misinterpretation. Dr. Brown claims that the FTC action is proof that Atmos' negotiation of the discounts was not motivated by the incentives of the PBR but instead was the result of East Tennessee's efforts to compete with SONAT. (Rebuttal Test. of Dr. Stephen Brown, p. 10.) Dr. Brown also (once again) accuses Atmos of lying in its response to the CAPD's request for documents forming the basis for Atmos' transportation decisions from 1999-2003. Dr. Brown claims the notification the FTC ordered El Paso to give was "surely" a foundational document in Atmos' transportation decisions from 1999-2003, and therefore should have been produced. (Id. at p. 21.) It is impossible for the FTC-ordered notification to have motivated or formed the basis for Atmos' negotiations of its transportation discounts.[13] The FTC order containing the notification requirement was issued on January 6, 2000, almost a full year after Atmos began negotiating for discounts, and almost four months after Atmos had completed its negotiations with East Tennessee Gas. (FTC Order (Sch. 1 to Brown Rebuttal Test.) at p. 15; Hearing Trans. Vol. I, pp. 28, 30 (Test. of John Hack).)

Dr. Brown also has no basis for his conclusion that the discounts were simply offered to Atmos and Atmos did not have to undertake any procurement efforts at all. Dr. Brown points to the allegation contained in the FTC complaint that East Tennessee began offering discounts as a result of the threatened competition by SONAT. (Rebuttal Test. of Dr. Stephen Brown, p. 9.) The purpose for that allegation was to demonstrate the type of beneficial competition that the FTC contended would not exist after the merger. Regardless, the fact that changes in the marketplace (i.e., SONAT's competition with East Tennessee and the threatened bypass pipeline) prompted East Tennessee to offer, for the first time, discounts on some of its contracts provides no indication whatsoever that East Tennessee called its customers and voluntarily offered discounts, or that the discounts were simply there for the asking. (Hearing Trans. Vol. II, pp. 75-76 (Test. of John Hack).) In fact, both Mr. Hack and Mr. Creamer, two individuals with years of experience in the negotiation of contracts in the gas industry, testified that they knew of no instance where discounts had been offered in such a manner, and they would consider such activity highly unusual. (Hearing Trans. Vol. I, p. 32 (Test. of John Hack); Vol. II, pp. 75-76 (Test. of Frank Creamer).) It is not surprising to learn that companies in business for profit do not voluntarily give discounts to their customers.

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[13] Dr Brown wrongly implies that the required notification somehow related to the FTC actions or the offering of discounts (Rebuttal Test of Dr Stephen Brown, p 21) Actually, the notification merely informed those holding contracts coming up for renewal of the potential change in ownership of East Tennessee, and extended the deadline for renewal of those contracts (Hearing Trans Vol II, pp 70-71 (Test of Frank Creamer))

From the very beginning of this case, Atmos has always maintained that discounted transportation contracts first became a feature in the marketplace in 1999. (See 10/21/02 Aff. of John Hack.) It is obvious that if transportation discounts were not available in the marketplace before 1999, but were available after 1999, that some change occurred in 1999 within the marketplace that altered the economic conditions so as to provide some incentive for the pipelines to offer discounts when they did not have the incentive to do so before. The competition between SONAT and East Tennessee referenced in the background allegations of the FTC's complaint merely explains what may have caused the shift in the marketplace that Atmos has always maintained occurred sometime in 1999.

The FTC order is not the first time Dr. Brown has supported the CAPD's positions in this docket with a misconstruction of regulatory action. After much delay and protest, the CAPD was ordered to state its substantive objections to the TIF tariff, for the first time, in its response to the joint proposal filed by the Staff and the Company. The bulk of the CAPD's written response outlining its objections, as well as the bulk of the CAPD's discovery requests to Staff and Atmos, was devoted to the now abandoned argument that the TIF tariff is inconsistent with a July 2003 FERC order which Dr. Brown contended reversed FERC's policy of encouraging negotiated transportation rates and found instead that negotiated transportation rates were not in the public interest.[14] Atmos conclusively demonstrated, in its reply to the CAPD's objections, that the 2003 FERC order cited by Dr. Brown did ***not*** reverse FERC's negotiated rate policy, but actually reaffirmed the policy's effectiveness and specifically rejected one commentator's suggestion to

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[14] Dr Brown asserted that negotiated transportation rates are not in the public interest even as the CAPD's other witness, Dan McCormac, argued that Atmos was obligated to pursue such rates, regardless of the terms of the PBR (CAPD's 5/4/04 Objections to Proposed Settlement, p 10, McCormac Aff attached thereto, ¶ 5) It appears that Dr Brown was arguing Atmos should not pursue transportation discounts because FERC found them contrary to public interest, while Mr McCormac was arguing that Atmos should pursue the discounts, but not share in any savings

eliminate the policy altogether. (See Atmos' 5/21/04 Resp. to CAPD's Objections to Settlement Proposal, p. 13.) The 2003 FERC order did recognize that contracts that employ basis differential pricing could present an opportunity for pipelines to manipulate the market to drive transportation prices up. (Id. at p. 14.) However, even if Atmos' contracts employed basis differential pricing, which they do not, the risk of manipulation would result in higher transportation prices, which would in turn ***decrease***, not increase, the savings Atmos would be allowed under the PBR. (Id.) Therefore, contrary to Dr. Brown's argument, even if the manipulation concerns outlined in the 2003 FERC order applied to Atmos' contracts, which they do not, those concerns would not have provided any reason for the TRA to prohibit Atmos from sharing in transportation savings under the PBR plan. Faced with the glaring errors in both Dr. Brown's interpretation of the 2003 FERC order and in the logic of his arguments based on that order, the CAPD abandoned its attempt to rely on the FERC order altogether.

The only evidence the CAPD has put forth in support of its argument that allowing Atmos to share in transportation savings under the PBR would allow the Company to share in savings it did not have to make an effort to earn is the testimony of Dr. Brown. Dr. Brown admitted he had no experience in this area, no personal knowledge of the negotiations, and that he had made no effort to contact any individuals involved in the negotiations or the industry as a whole. Dr. Brown's assertions in this docket have been repeatedly shown to be inaccurate, and his conclusions, unsupported. Dr. Brown's willingness to accuse other witnesses of lying under oath without sufficient basis further damages his credibility as a witness. Dr. Brown's testimony on the issue of Atmos' negotiation of the discounts at issue should therefore be disregarded. The evidence demonstrates that Atmos' request to share in the savings from the transportation discounts through the TIF amendment is justified by the extraordinary effort Atmos undertook to negotiate the discounts.

D. ***The Transportation Discount Generate Real Savings.***

The CAPD also argues, through the testimony of Dan McCormac, that the transportation discounts do not generate real savings because the discounts may not result in the lowest cost gas for consumers. (Direct Test. of Dan McCormac, p. 8 and Att. A.) To support this theory, Mr. McCormac posits a hypothetical in which the Company purchases higher cost gas in order to obtain transportation savings, thus resulting in higher prices for consumers. (Id.) In Mr. McCormac's hypothetical, the Company opts to purchase gas from the Henry Hub receipt point for $5.50 delivered cost even though the gas could be purchased in Murfreesboro (in a purchase without a transportation component) for the same delivered cost. (Id.) However, Mr. McCormac's hypothetical is overly simplistic and does not reflect the realities of the Company's gas supply purchases. (Rebuttal Test. of John Hack, p. 2.)

Even assuming the total delivered cost for the two purchases described in his hypothetical would ever be the same, which Mr. McCormac does not establish and which has not been the Company's experience, the hypothetical ignores additional considerations the Company must take into account in making purchasing decisions, including operational, reliability, and safety concerns. (Id.) Purchases without a separate transportation component like the "Murfreesboro" example cited in Mr. McCormac's hypothetical are spot purchases of locally produced gas. (Id.; Hearing Trans. Vol. I, pp. 40-43 (Test. of John Hack).) Such purchases are not generally backed by primary firm transportation and therefore may not be available on critical days. (Hearing Trans. Vol. I, pp. 40-43 (Test. of John Hack).) The purchases also raise safety concerns, stemming from the fact that most locally produced gas comes from shallow wells, and is lower in quality and pressure. (Id.) In order to meet its service obligations, the Company follows a general practice of subscribing to the more reliable primary firm transportation (Id.; Rebuttal Test. of John Hack, p. 2.)

It is highly unlikely that a purchase of locally produced gas as described in Mr. McCormac's hypothetical would result in higher total cost for the consumer because the Company would have to also purchase backup capacity in addition to the spot purchase of the locally produced gas. (Hearing Trans. Vol. I, pp. 40-43 (Test. of John Hack).) Even assuming the Company's choice to use primary firm transportation rather than spot purchases of locally produced gas could ever result in a higher ultimate cost for the consumer, the higher price would not be incurred because of the Company's desire to recoup transportation savings, but because of the Company's obligation to provide reliable and safe service. (Rebuttal Test. of John Hack, p. 2.)

Contrary to Mr. McCormac's position, permitting Atmos to share in savings from transportation discounts does not result in higher prices for consumers.

E. ***The TIF Tariff Represents a Reasonable Balancing of Risks and Rewards.***

The CAPD argues that the TIF tariff violates core principles established in the original PBR case because the use of maximum FERC rates as a benchmark eliminates any risk or penalty for the Company. (Direct Test. of Dr. Stephen Brown, pp. 4-7.) First, Dr. Brown is incorrect in stating that Atmos does not incur any risk in negotiating transportation discounts. (Rebuttal Test. of Frank Creamer, pp. 2-3.) Atmos dedicates scarce and limited resources, both human and physical assets, to obtaining these discounts, and to the extent that Atmos is unsuccessful in negotiating a discount, Atmos loses the return on that investment. (Id.)

Dr. Brown also misstates the core principles of the PBR plan. The goal of the PBR plan is to provide incentives for Atmos to engage in innovative sourcing behaviors (both commodity and transportation) to "beat the market" and maximize cost savings opportunities that are consistent with the TRA's guiding principle when implementing the PBR in 1995 - "to look to incentive programs and more streamlined regulation to improve efficiency and hold down costs to consumers." (Id.) Consequently, the crucial component of the PBR is not whether the transportation marketplace has pricing penalties that are similar to the pricing penalties that exist in the commodity marketplace, but rather the existence of a standard of performance that reflects each individual and unique marketplace against which Atmos's sourcing performance (both commodity and transportation) can be determined. (Id.)

Dr. Brown's argument that the maximum FERC rate cannot be the benchmark for judging Atmos' purchases is based on his assumption that a maximum price can never be a proxy for the marketplace. (Direct Test. of Dr. Stephen Brown, p. 6.) Dr. Brown's assumption is based on an incorrect application of the market index design principles for the gas commodity marketplace to the transportation pipeline marketplace. (Rebuttal Test. of Frank Creamer, pp. 2-3.) As established by the testimony of Frank Creamer, the two marketplaces are entirely different. (Id.) To be effective, any benchmark must reflect the actual marketplace that it is attempting to replicate, not some other marketplace with a totally different structure. (Id.) Since the gas commodity marketplace contains a population of multiple transactions each with different paired values, without price ceilings or floors, the market proxy for that marketplace is the numerical average of the multiple market transactions reported during the measurement window. (Id.) However, since the transportation marketplace contains only single point-in-time pricing information for a transaction with a population of "1", has a price ceiling (e.g. maximum FERC rate) and contains unique contract terms and conditions, the proxy for this marketplace certainly cannot include prices higher than "seen" in the marketplace nor should it include a numerical average of all transactions in the marketplace. (Id.) The absence of "purchases" above the market index average for the transportation marketplace, as noted by Dr. Brown, is irrelevant and does not preclude determining a proper proxy for the transportation marketplace as outlined above. (Id.)

Contrary to the CAPD's arguments, the absence of pricing penalties in the TIF tariff does not provide a reason to deny the proposed amendment.

F. ***The TIF Tariff Is Not Inconsistent With the Ruling in the Uncollectibles Docket.***

CAPD witness Dan McCormac argued that the proposed changes contained in the TIF tariff are inconsistent with the TRA's recent ruling in Docket No. 03-00209, permitting gas companies to recover the gas costs portion of uncollectibles expense through the Purchased Gas Adjustment ("PGA") rule. (Direct Test. of Dan McCormac, p. 5.) Mr. McCormac portrays the uncollectibles ruling as representing a recent shift in regulatory policy towards passing more costs on to consumers. (Id.) Mr. McCormac's characterization of the ruling in the uncollectibles case is inaccurate. The shifting of gas costs from the Company to the consumer is not a new concept - the Company has been entitled to recover 100% of its gas costs from the consumer since the enactment of the PGA rule in the 1970s (Rebuttal Test. of Frank Creamer, p. 6; Hearing Trans. Vol II, p. 137 (Test. of Dan McCormac).) Atmos has been able to share in cost savings since the PBR was implemented almost a decade ago. (Rebuttal Test. of Frank Creamer, p. 7.) These are not new concepts. The uncollectibles ruling simply clarified that the gas costs portion of bad debts is indeed gas costs, and therefore is within the intent and scope of the PGA rule. (Id.)

Contrary to Mr. McCormac's position, the ruling in the uncollectibles case actually supports Atmos' position in this docket. (Id.) In the uncollectibles case, the TRA ruled that, contrary to the CAPD's argument that the petition should be denied because uncollectible accounts were not specifically mentioned in the PGA rule or provided for in the formulas used, recovery of those costs is consistent with the intent of the PGA rule to ensure that Atmos does not over or under collect gas costs. (Id.) The uncollectibles ruling is an example of the TRA rejecting the CAPD's hyper-technical elevation of form over substance in favor of a more flexible approach which focuses on the overall intent and scope of the rule, not merely its specific language. (Id.)

In this case, it is true that negotiated transportation discounts are not specifically mentioned in the PBR plan, because such discounts did not exist when the PBR plan was created. However, it is clear that allowing Atmos to share in the savings generated from those discounts is consistent with the intent and scope of the original PBR plan, which is to span the entire spectrum of all gas procurement, storage, and capacity activities and provide Atmos with an incentive to find innovative ways to reduce all costs of purchasing, delivering, and storing gas to the end consumer, including transportation costs. (Id.)

G. ***The TIF Tariff Should Not Be Denied Due to Industry Events or the Existence of Affiliate Relationships.***

Mr. McCormac makes the blanket assertion in his testimony that the TIF tariff should be denied because unspecified events in the industry as a whole cast doubt on the reliability of the market indices, and because of concerns with Atmos' relationship with its affiliate. (Direct Test. of Dan McCormac, p. 6.) Although Mr. McCormac did not elaborate in his testimony as to the exact bases for his assertions, he admitted on cross examination that the CAPD lacked both the time and the expertise to investigate his allegations. (Hearing Trans. Vol. II, pp. 127-28.) The handful of articles cited in discovery responses as the foundation for Mr. McCormac's concerns regarding the reliability of certain commodity market indices have no relevance to the question of whether the maximum FERC rate is an appropriate benchmark to measure Atmos' performance in procuring gas transportation. (Rebuttal Test. of Frank Creamer, pp. 7-8.) Mr. McCormac provided several articles that referred to potential and alleged abuses in companies' voluntary reporting of ***commodity purchases*** (emphasis added) to the Inside FERC gas commodity index. (Id.) The articles do not even discuss any potential for manipulation in the posted maximum FERC transportation rates, which unlike the commodity indexes, are set through the FERC ratemaking process and not through compilation of voluntary reporting from companies within the industry. (Id.) The bottom line is that, even if Mr. McCormac's uninvestigated suggestions about possible manipulations of the commodity indexes did turn out to be justified, it would have no effect whatsoever on the validity of the maximum FERC rate as a standard of performance in Atmos' PBR plan, or on the appropriateness of the TIF tariff. (Id.)

Mr. McCormac's concerns regarding the reliability of the gas commodity market indices and Atmos' relationship with its affiliate are simply a rehash of the arguments the CAPD made when it opposed the original PBR plan (Phase 2 Order, pp. 10-25; Phase 1 Order, pp. 19-24.) The TRA rejected the CAPD's arguments regarding the reliability of the commodity market indices by noting that the gas commodity component of the PBR was intentionally designed to rely on the averaging of three indices with a deadband and an earnings cap so as to minimize the impact of any data or market anomalies. (Phase 1 Order, pp. 19-24; Rebuttal Test. of Frank Creamer, p. 8.)

Mr. McCormac's position actually provides further support for the separation of the commodity and transportation components within the PBR through a TIF factor. The TIF tariff proposed by Atmos would actually facilitate any modifications, additions, and/or deletions of the gas commodity market indices should such modifications ever become necessary, without affecting the transportation component. (Rebuttal Test. of Frank Creamer, p 8.)

The TRA also rejected the CAPD's previous argument that Atmos' relationship with its affiliate, Woodward Marketing, constituted sufficient reason to deny implementation of the original PBR. In rejecting the CAPD's argument, the TRA noted that the CAPD's accusations of fraud and manipulation were baseless, and questioned whether the CAPD understood the basic provisions of the contract. (Phase 2 Order, pp. 15-21.) The TRA specifically found that the Woodward contract was "good, if not exceptional" and was in the best interest of the Company and consumers. (Id. at p. 20.) The TRA also adopted specific affiliate guidelines which govern Atmos' relationship with its affiliate. (Rebuttal Test of Pat Childers, p. 1.) These guidelines, together with the TRA's ruling in the original PBR case, remove all doubt that the CAPD's arguments are not well-founded, and provide no basis to deny the proposed TIF tariff

H. ***Implementing the TIF Tariff Effective April 1, 2001 Does Not Constitute Retroactive Ratemaking.***

Finally, the CAPD argues that implementing the TIF tariff effective April 1, 2001 would result in retroactive ratemaking. (Direct Test. of Dan McCormac, pp. 10-11.) The only evidence the CAPD presented in support of its claim of retroactive ratemaking was the testimony of CAPD analyst Dan McCormac, who admitted that his opinion regarding retroactive ratemaking was a legal opinion which, as an accountant, he is not qualified to make. (Hearing Trans. Vol. II, pp. 132-35.)[15]

The general prohibition on retroactive ratemaking comes from the language of the statute granting the TRA's ratemaking authority, Tenn. Code Ann. § 65-5-101, which states that the TRA has the power to fix rates "which shall be imposed, observed and followed *thereafter*" (emphasis

[15] Mr McCormac was asked in a discovery request to identify all facts he relied upon in reaching his conclusion that the TIF would constitute retroactive ratemaking and to produce all documents, including, without limitation, all "statutes, rules, orders, and cases" that he reviewed or relied upon in reaching that conclusion (Atmos' 8/13/04 Post-Testimony Discovery Req to the CAPD, Req No 8) Mr McCormac responded that he relied upon "his personal experience," "the current record," and "simple logic " (CAPD's 9/1/04 Resp. to Atmos' Post-Testimony Req , pp 13-14) On the stand, Mr McCormac claimed, contrary to his discovery response, that he reviewed the opinions in the following cases in reaching his conclusion AARP v Tennessee Pub Svc Comm'n, 896 S W 2d 127 (Tenn Ct App 1994) and Consumer Advocate Division v TRA , 2000 WL 13794 (Tenn Ct App Jan 10, 2000)

added). South Central Bell v. Tenn. Pub. Svc. Comm'n, 675 S.W.2d 718, 720 (Tenn. Ct. App. 1984). In a case with similar facts as the matter at hand, the Tennessee Court of Appeals specifically held that allowing utilities to share in past earnings through prospective rate adjustments, as the proposed TIF tariff does, does ***not*** constitute impermissible retroactive ratemaking. American Ass'n of Retired Persons ("AARP") v. Tenn. Pub. Svc. Comm'n, 896 S.W.2d 127, 134 (Tenn. Ct. App. 1994). In that case, the AARP argued that the telecommunication regulatory reform plan provision which allowed local exchange carriers to share in earnings in excess of a certain range was impermissible retroactive ratemaking. 896 S.W.2d at 134. The court rejected that argument, holding that the sharing plan did not result in retroactive ratemaking, and noting that the rule called for the carriers to recoup past shared earnings through adjustments in future rates. Id.; see also Consumer Advocate Division ex rel. v. Tennessee Regulatory Authority, 2000 WL 13794 at *3 (Tenn. Ct. App. Jan. 10, 2000) (holding that BellSouth's price regulation plan did not constitute impermissible retroactive ratemaking because the only rate changes under the plan would be prospective).

If the TIF tariff is implemented effective April 1, 2001, all agreed-upon losses and savings will be recouped by Atmos and the consumers the same as any sharing under the PBR plan - through adjustments in future rates. Under Atmos' PBR plan, 100% of the savings from all avoided costs, including savings from negotiated transportation discounts, are immediately passed through directly to the consumers through the Company's Purchased Gas Adjustment ("PGA") procedure (See Atmos' 5/21/04 Resp. to CAPD's Objections to Settlement Agrmt , pp. 9-10.) When the Company negotiates a transportation discount, it subsequently files a PGA with the TRA to adjust consumers' rates to reflect the actual gas cost Atmos incurs. Atmos recoups its 50% share of those savings annually through a rate increase beginning each October 1, when the

Company files its PBR factor true-up. Therefore, for example, when the Company negotiated the discount transportation contracts which became effective November 1, 2000, 100% of the savings from those contracts were passed through to the consumers through Atmos' periodic PGA filings. (Id.) On October 1, 2001, Atmos filed its PBR true-up for the preceding PBR plan year. That true-up filing included a calculation of Atmos' share of the total amount of transportations savings for the preceding year (50% of the total savings), and divided that amount by the prior year's sales to arrive at a surcharge rate increase that would allow Atmos to recoup its share of the savings over the following year. The rate increase that was implemented on October 1, 2001 to allow Atmos to recover for all of the avoided costs (commodity and transportation) under both incentive mechanisms of the PBR was $0.00444 per ccf. (Id.)

Atmos has not filed any audit reports for audit years 2001-2002, 2002-2003 and 2003-2004. (Hearing Trans. Vol. II, pp. 87-89 (Test. of Pat Murphy).) TRA Staff agrees that because the Staff has yet to even begin the audits of the 2001-2002, 2002-2003 and 2003-2004 plan years, those audit years remain open. (Id.) The TIF tariff will begin effective April 1, 2001 (Day 1 of the year following the year at issue in the Audit Case) and Atmos will have 45 days to file its annual report for the following plan years. Any savings Atmos receives will, like any refund that may be ordered in the Audit Case, be accounted for in adjustments to future rates.

The legal prohibition on retroactive ratemaking, therefore, places no impediment whatsoever to how the Company will calculate and report transportation cost savings when it eventually files its annual reports for those years. This is precisely the arrangement that was specifically held valid in the AARP case discussed above, and there can be no question but that the contemplated procedure does not violate the prohibition on retroactive ratemaking. Indeed, if the TIF tariff constitutes impermissible retroactive ratemaking, then not only is the entire PBR and

PGA true up procedure also invalid, the Authority would not have the power to order Atmos to refund the amount at issue in the Audit Case through adjustments in future rates, should the TRA reject Atmos' objections.

This is not the first time the CAPD has taken a position with regard to retroactive ratemaking which elevates a hyper-technical objection to form over substance The CAPD has dragged the retroactive ratemaking objection out in at least two previous cases appealed to the Tennessee Court of Appeals, and the CAPD's approach on this issue has garnered scorn and disdain from the court.

In 1998, the CAPD appealed the TRA's order granting Nashville Gas Company a rate increase. Consumer Advocate Division v Tennessee Regulatory Authority, 1998 WL 684536 at *3 (Tenn. Ct. App. July 1, 1998). Among other objections, the CAPD argued that the TRA's order on the rate increase was invalid retroactive ratemaking. Id. The TRA held the hearing on the rate increase on December 17, 1996. Id. at *1. At that hearing, the TRA issued its ruling orally, and held that the new rates it had approved would go into effect January 1, 1997. Id. The TRA did not issue its written order on the ruling until February 19, 1997. Id. However, Nashville Gas notified the TRA in late December that it would implement the Authority's oral ruling and begin charging the new rates January 1, 1997 as specified. Id. The CAPD argued that Nashville Gas had no authority to implement the rate increase in January, and that the TRA's February 19, 1997 order amounted to retroactive ratemaking. Id. at *3. The court summarily rejected CAPD's argument, noting that the retroactive argument "exalts form over substance." Id. at *3.

In 1996, the CAPD argued that the TRA's order requiring Kingsport Power Company to pass along to consumers any refund it received from its supplier due to a rate increase subsequently invalidated by the Federal Energy Regulatory Commission ("FERC") was impermissible retroactive ratemaking. Consumer Advocate Division v. Bissell, 1996 WL 482970 at *3 (Tenn. Ct. App. Aug. 28, 1996). Again, the Court of Appeals rejected the CAPD's retroactive argument, noting that the refund was the final step in a federally mandated ratemaking scheme. Id. at *3. The court also expressed puzzlement over CAPD's position, noting that if CAPD were correct that the refund constituted retroactive ratemaking, the logical conclusion would be that Kingsport Power would keep the refund it received from its supplier, thus resulting in a windfall to the company at the expense of the ratepayers. Id.

Like the cases discussed above, the CAPD's retroactive ratemaking objection in this matter is without any legal basis whatsoever.

VI. **CONCLUSION.**

This is a case of the PBR plan working just as it was intended. Atmos, motivated by the financial incentives of the PBR, took advantage of changes within the marketplace and expended an extraordinary amount of effort to negotiate transportation discounts. The evidence in this proceeding has demonstrated that Atmos is entitled to share in the savings resulting from those discounts under the terms of the current PBR plan. The evidence has also demonstrated that the TIF amendment Atmos has proposed, with the support of TRA Staff, for the years subsequent to the audit year is just and reasonable and is in best interest of the Company and the consumers. All of the parties agree that unless the TRA finds that transportation savings are included in the PBR, either under the current plan, or through the proposed TIF amendment, that the TRA has no choice but to hire a consultant to conduct an annual prudency audit of Atmos' transportation purchases, an exercise which the TRA unanimously rejected a decade ago as costly, inefficient, and contrary to the public interest. For these reasons, Atmos' objections to the 2000-2001 audit should be sustained. In addition, the proposed TIF tariff should be approved effective April 1, 2001.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served via U.S. Mail, postage prepaid, upon the following this the 22nd day of November, 2004:

Russell T. Perkins
Timothy C. Phillips
Office of the Attorney General
Consumer Advocate & Protection Division
P.O. Box 20207
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Randal L. Gilliam
Staff Counsel
Tennessee Regulatory Authority
460 James Robertson Parkway
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2830844-000077 11/22/2004

[redacted]

United Cities Gas Company

Mark G Thessin
Vice President - Rates & Regulatory Affairs

June 1, 1999

Mr. David Waddell, Executive Director
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

RE: Docket No. 97-01364
<u>United Cities Gas Company</u>

Dear Mr. Waddell,

In conformance with the Tennessee Regulatory Authority's (TRA) decision in Phase II of United Cities Gas Company's Performance Based Ratemaking (PBR) program and the tariff effective April 1, 1999 that was filed in compliance with the TRA's decision, the Company hereby submits its incentive/bonus program for non-executive employees in its gas supply department.

Under the Company's variable pay program, non-executive employees in the Company's gas supply department are eligible to receive additional pay or a bonus based on several weighted measures. For gas supply employees these measures consist of corporate measures involving earnings per share of Atmos, the net income of each business unit including United Cities, and shared services O&M expenses. The corporate earnings and shared services are weighted 25% each, with the business unit net income weighted 50%. Since the corporate and business unit measures are based on earnings and net income, the performance or lack of performance of each incentive program managed by gas supply personnel has an impact on the level of earnings or net income achieved. Dependant on the success of these programs, the opportunity for a variable pay payout for the gas supply personnel ranges from 2% to 10% of the individual's salary.

I would respectfully request that the TRA treat the filing as confidential since the filing involves sensitive employee information. In the event that any party should wish to use this information in the public domain, the Company would seek the opportunity to forward its arguments on why such a request would not be in the public interest.

If you should have any questions, please feel free to contact me at 615.771.8330.

Sincerely,

Mark G. Thessin

Mark G. Thessin

Cc: Consumer Advocate Division

United Cities Gas Company

Mark G Thessin
Vice President - Rates & Regulatory Affairs

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Sincerely,

Mark G. Thessin

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Cc: Consumer Advocate Division

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